THE
UNIVERSITY OF CHICAGO LAW REVIEW
VOLUME 16 SUMMER 1949 NUMBER 4

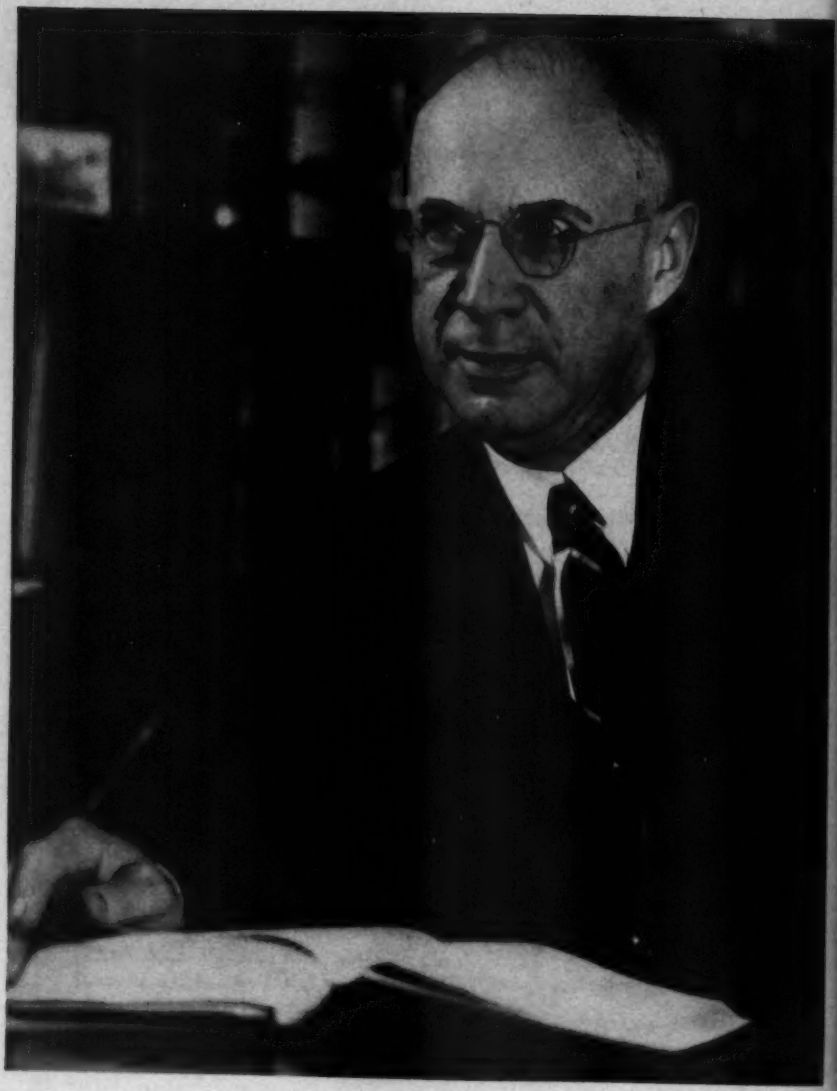
APPRECIATIONS

I

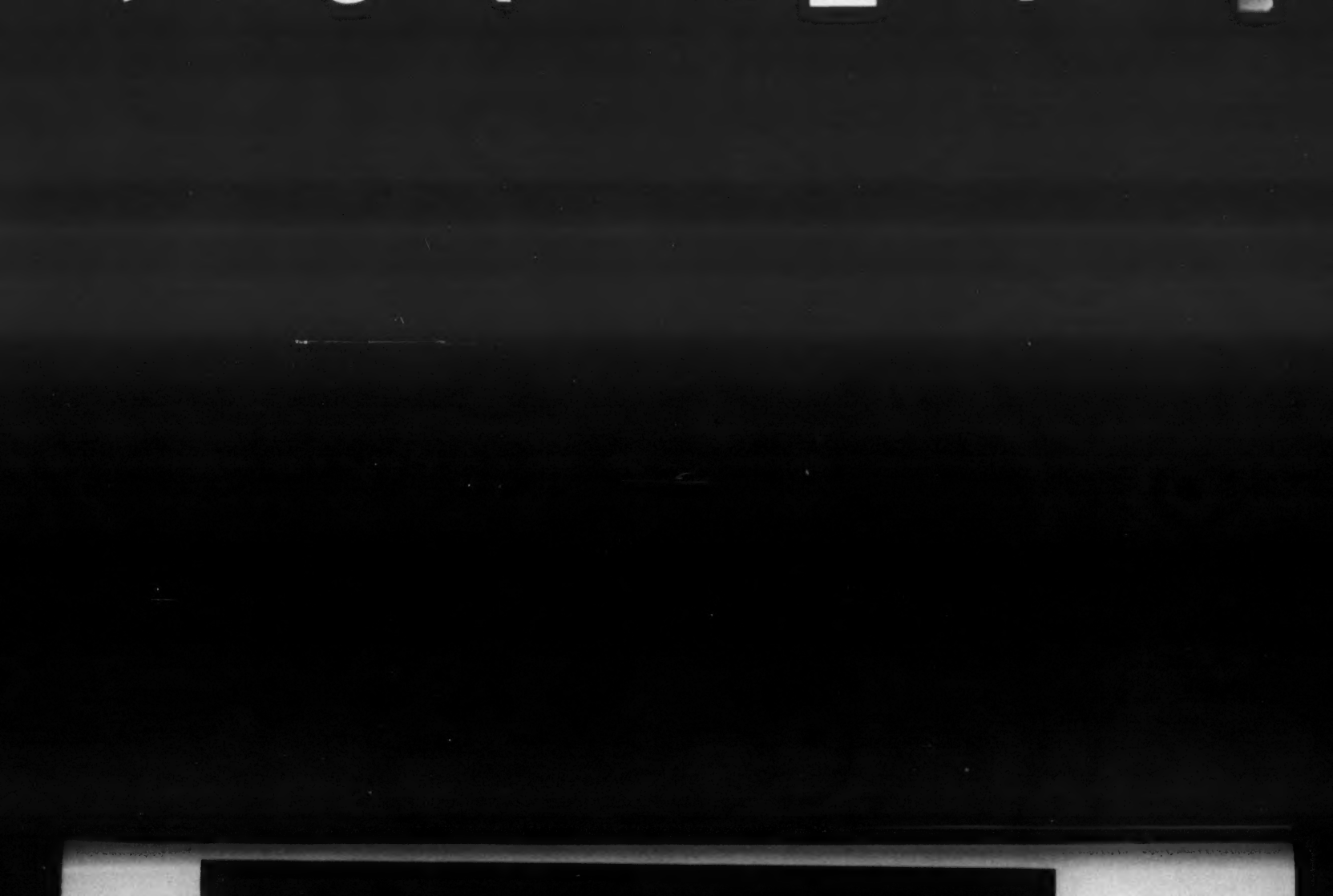
GEORGE GLEASON BOGERT, after four years of practice at the New York Bar and a teaching career at Cornell University Law School that had led to his appointment in 1921 as Dean of that school, joined the faculty of the University of Chicago Law School in October 1925. For almost a quarter of a century he has lived and worked with the School as one of the outstanding members of the faculty, recognized as such both within and without the law school world. This year he becomes Emeritus.

There are various aspects from which may be judged the value of the services and contributions of the person who takes for his vocation what may be loosely designated as the teaching branch of the legal profession. "Loosely designated" because one who enters upon it soon recognizes that it is a Protean calling. The aspect most obvious is that of instruction by the direct method of the classroom and personal conferences; the critical examination and exposition in print of one or more phases of the law in greater fullness than the classroom will permit is another; the correlating of law with other elements in our social and economic structure is another; work for the rectification of socially undesirable or inconsistent elements in the legal system is another. It is hardly necessary to observe that these fields are neither exhaustive nor mutually exclusive. The classifications may, however, serve as a sufficient basis for this brief examination of the career of the one to whom this number of the Law Review is dedicated.

The success of an instructor in the classroom may be measured by various criteria. In the long run the most valid one seems to me to be how much the intelligent student feels that he "got out" of the course. Two of the main elements underlying his judgment in this regard will be the extent to which his analytical abilities were stimulated or how much he was



GEORGE G. BOGERT



made to think like a lawyer, and how great was his confidence in the definiteness and extent of the instructor's command of the subject matter with which he was dealing. One of the outstanding characteristics of Professor Bogert is the untiring thoroughness with which he attacks any subject. Manifest in his exhaustive work on Trusts, it is no less so in his immediate command of the material as a background to his classroom work. One former student expressed it by saying, "If Professor Bogert said that it was so, you never had any doubt about it." The corollary to this extensive knowledge of his subject is a fund of cases "not in the book" from which a selection at the conclusion of a general discussion or at a deadlock in argument would keep the interest of the class at the peak. With this completeness of grasp of the subject on his part has come an expectation of cooperation and alertness on the part of the student. Kindly of heart though Professor Bogert is, he does not suffer fools gladly, and the unlucky wight who attempts to substitute talk for understanding has short shrift. Yet, equally emphasized by his students is his patience outside the classroom in devoting whatever amount of time may be necessary for the clearing up of matters that the classroom discussion has left obscure. With this background and attitude, it is not surprising that the high grades in his courses are sparingly bestowed and thoroughly earned.

It is a commonplace today in legal instruction to recognize and, with varying degrees of emphasis, to insist on a consideration of and a correlation with other related aspects of the subject matter of the course. There are usually numerous possibilities of such affiliation. All through the many years of Professor Bogert's life as a teacher, he has sought to vivify for the students the problems with which they were dealing. The supreme court case, the decision of which they are studying, was once a trial court case; before that it was a transaction, commercial, familial, or otherwise, and that is where the source of the litigation is to be found. In emphasizing the desirability of bringing home to the potential lawyer the arrangement problems that permeate everyday dealings between individuals and the various devices that have been adopted to cope with these problems, Professor Bogert both by his classroom work and in his publications has been one of the pioneers in a technique that has become progressively more common. A good illustration of his method is given in the seminar in Consumer's Credit which he gives from time to time. The seekers of credit may be purchasers of anything from a radio to a railroad. Professor Bogert introduces to his seminar representatives from household finance companies, auto dealers, and banks to discuss the difficulties of their respective strata of credit financing, and their devices for meeting those difficulties.

The subject of Trusts of course presents many problems and opportunities in which he has employed similar methods.

The strong desire of Professor Bogert to tie "law in books" to "law in action" that has just been mentioned has lead him inevitably to take a vigorous part in activities devoted to legislative changes where the common-law doctrines were too definitely fixed for change by judicial action, or where previous legislation was no longer adequate. His work as a member of the Commission on Uniform State Laws, first from New York and then from Illinois, which first began in 1920, and more particularly his work in the drafting of the Uniform Conditional Sales Act, are instances of his efforts in this aspect of the profession. As to his writing, res ipsa loquitur, it ranges in subject matter from the masterly and perennially renewed treatise on Trusts to magazine articles dealing for the most part with one or another of the multifarious problems of trusts and business relations. These contributions to the law began in 1911 and are still continuing. They all have a careful exposition of the law on the subject so far as it has taken definite form. They also have an ever present consideration of the extent to which the Law harmonizes with business practice; they evaluate the effectiveness of the current legal devices, and, when the need exists, they consider the possibility and method of remedying the situation. The treatises on trusts as well as his other publications on a somewhat more limited scale exemplify another of his characteristics already referred to, namely, his untiring thoroughness in the work at hand.

Thus, during all of his professional career, Professor Bogert has had a well rounded life; his activities have been manifold and he has gained distinction in them all. In the council chamber of school policies, local or national, his approach has been that of thoughtful consideration. An educational policy is not necessarily good because it is well established; on the other hand that fact does not necessarily make it bad: this expresses, I think, his general point of view. His careful weighing of considerations, his forthrightness of expression of his position assure him always of attention irrespective of what may be the final solution of the problem at hand.

Of the man I have said nothing. To the many who know well the quiet voice, the acute observation and the dry humor behind it, any comment is superfluous. Judging him from either or both points of view, professional or human, we can only regret that time has made this inroad upon the faculty and, with the certainty that our wish will be fulfilled, wish him success in his next professional adventure.

HARRY A. BIGELOW*

* Dean Emeritus, University of Chicago Law School.

II

I have been a colleague of George Bogert for almost twenty years, but I remember clearly his encouragement and help in my first year at the Law School. We took weekly rides together on the bridle paths of the Midway and Washington Park. Riding and teaching were both new to me, and both seemed unduly hazardous. I needed his counsel, and I remember particularly his injunction that one should immediately remount if thrown by a horse—or by a class.

I am glad of the opportunity to add a few comments to the words of Dean Bigelow who speaks for all of us on the faculty. I want to mention Mr. Bogert's extraordinary power of oral exposition. I remember a state bar association meeting at which he explained one of the uniform acts in the field of trusts with a clarity and force and persuasiveness which I have not seen equalled.

Practitioners in the fields of his specialization do not always agree with the views he expresses with such independence and vigor. He is always listened to, however, for he adds balanced judgment to competent analysis and scholarship.

"Bogert on Trusts and Trustees"—how many of the lawyers who use it regularly realize the years of patient work which went into these volumes and the continuing effort which still keeps them up to date? The truth is that few of the present generation of law teachers are willing to undertake a task of these proportions. Comprehensive treatises are being left to the editorial staffs of law publishing firms while academic men are usually satisfied with occasional law review articles. To be sure the material in most fields has swollen to a formidable mass, and it takes unusual devotion and self-discipline to bring a large treatise to completion.

When a man of Professor Bogert's ability and vigor becomes Emeritus, it raises sharply the question of academic retirement policy. This may be a problem which defies satisfactory solution, but it is a curious system which enables the Hastings School of Law to reach national fame through the rigid policies of other schools. In his teaching at Hastings and in continuing his writing and consultative practice, Mr. Bogert will have the warm good wishes of faculty, students, and alumni of the University of Chicago.

WILBER G. KATZ*

* John P. Wilson Professor of Law and Dean, University of Chicago Law School.

THE DRIFT TOWARD A CONSUMER CREDIT CODE*

F. B. HUBACHEK†

IN THE December 1944 issue of this Review, Professor George G. Bogert presented a valuable article on the future of small loan legislation.[1] During the ensuing years the trends of legislation in that field have been in the direction he advocated, although progress has been slow and erratic. The subject in both its legal and economic aspects is now in just as dynamic a phase as it has been since late in the nineteenth century. Another treatment of the subject may not now be premature.

This paper will attempt to bring Professor Bogert's article up to date, to point out some of the influences which have been at work, to suggest future developments, and to supplement certain of Professor Bogert's conclusions. His scholarly discussion was a landmark in a field which has been little understood and much misunderstood. Ancient prejudices, preconceived but unfounded beliefs, and the pleadings of special interests have often obscured the real elements of the problem and distorted the true nature of the public interest. In his matter-of-fact way, Professor Bogert made clear the desirability of a rational, factual, systematic approach to a code of regulatory laws dealing with the modern socio-economic problems of consumer installment credit.

As this paper will start where he stopped, it seems necessary to set forth a summation of his foundation article. Professor Bogert noted that "[i]n the last quarter of the nineteenth century there arose sporadically an appreciation of the woeful condition of the small borrower and of the need for special legal attention to his relief." Conventional usury laws fixed maximum percentage interest rates of universal application, failing to recognize that a rate which made a large loan profitable would produce a

* This article was written during March 1949, and speaks as of December 31, 1948 unless otherwise indicated. The sentence to which note 60, infra, is appended was added on June 15, 1949. A summary of consumer credit legislation from January to June 1949 appears in the Bulletin of the Law Forum of the National Consumer Finance Association, Washington, D.C.

† Member of the Illinois Bar. General Counsel, Household Finance Corporation. Alternate of Price Administrator under Presidential Order in drafting and administration of Regulation W, 1941–43. For many years Chairman, Law Committee, American Association of Personal Finance Companies. Now Chairman, Committee on Law Bulletin, Law Forum of National Consumer Finance Association.

[1] Bogert, The Future of Small Loan Legislation, 12 Univ. Chi. L. Rev. 1 (1944).

dollar amount on a small loan which was less than the lender's costs. Usury laws were not enforced because that required legal action by an individual borrower, and the overcharge for a small loan was usually less than the costs of the necessary litigation. The growing demand for individual credit in small amounts was supplied at high and usurious rates under oppressive conditions. Legislatures, convinced that borrowers were characterized by need, economic weakness, and lack of adequate legal remedies, began by attacking isolated features such as wage assignments and chattel mortgages, then turned to regulation of and grants of special powers to classes of lenders.[2]

Professor Bogert referred to the resulting legislation either as "miscellaneous, casual, and unsystematic reform measures attempting to improve the condition of the small borrower," or as "systematically prepared statutes, each of which relates to one type of lending agency only." The result was a "hodgepodge of inconsistent rules and controls, favoring some lenders and borrowers." Professor Bogert asked four basic questions and developed the following reasoned conclusions: 1) The states should regulate the small loan business. 2) Regulation should include fixing maximum rates of charge. 3) A uniform method of stating the rate of charge should be applied to all lending agencies, though the maximum rates may differ. 4) An over-all percentage rate of charge computed as simple interest on the unpaid principal balances of a loan is the best form of rate statement.

In Professor Bogert's article, it was implicit that, as the result of an expanding demand for consumer credit and the entry of new types of creditors into the business, small loans had become only part of a larger

[2] For detailed and comprehensive discussions of the problem and corrective steps, see Gallert, Hilborn, and May, Small Loan Legislation, esp. cc. i–iv, vi (Russell Sage Foundation, 1932); Robinson and Nugent, Regulation of the Small Loan Business, esp. cc. i, iii (70–73), iv, v (Russell Sage Foundation, 1935); Wassam, The Salary Loan Business in New York City (Russell Sage Foundation, 1908); Ham, The Chattel Loan Business (Russell Sage Foundation, 1909); Ryan, Usury and Usury Laws 127 et seq. (1924); Provident Loan Society of N.Y. v. Chambers, 88 N.Y.S. 2d 459 (1949), N.Y. L.J., p. 995, col. 5 (March 18, 1949).

The plight of the small borrower under the usury laws and the necessity for remedial legislation are shown by numerous decisions, including the following: Madison Personal Loan, Inc. v. Parker, 124 F. 2d 143 (C.C.A. 2d, 1941); In re Home Discount Co., 147 Fed. 538 (D.C. Ala., 1906); State ex rel. Smith v. McMahon, 128 Kan. 772, 280 Pac. 906 (1929); Davis Loan Co. v. Blanchard, 14 La. App. 671, 129 So. 413 (1930), rehearing den. 130 So. 472 (1930); Liberty Finance Co. v. Catterton, 161 Md. 650, 158 Atl. 16 (1932); State ex rel. Goff v. O'Neil, 205 Minn. 366, 286 N.W. 316 (1939); State ex rel. v. Family Loan Co., 167 Tenn. 654, 73 S.W. 2d 167 (1934); Cotton v. Cooper, 209 S.W. 135 (Tex. Com. App., 1919), aff'g 160 S.W. 597 (Tex. Civ. App., 1913). See Simpson, Cost of Loans to Borrowers under Unregulated Lending, 8 Law & Contemp. Prob. 73 (1941); Birkhead, Collection Tactics of Illegal Lenders, 8 Law & Contemp. Prob. 78 (1941). For other references, see Barrett and Ulrich, Index to Legal Literature on Regulation of Consumer Installment Lending and on Usury Laws (Law Forum of National Consumer Finance Association, 1948).

problem.[3] There are now several types of agencies which extend credit to the consumer by different methods. Knowledge of the relative importance of these agencies will assist in understanding the issues to be considered in this article (Table 1).

TABLE 1

CONSUMER INSTALLMENT CREDIT[4]

(December 31, 1948)

	(Millions)	
Sales financing:		
Incidental to automobile transactions	$1,961	
Incidental to sale of other goods	2,134	$4,095
Installment loan credit:		
Commercial banks	$1,709	
Small loan [consumer finance] companies	817	
Industrial banks and loan companies	364	
Credit unions	312	
Miscellaneous lenders	131	3,333
FHA repair and modernization paper		768
Total consumer installment credit		$8,196

It will be seen from Table 1 that the four principal types of installment credit agencies[5] are consumer finance (small loan) companies, industrial

[3] For recognition of interrelationship of all forms of consumer finance, see Report of Indiana Department of Financial Institutions on Indiana Consumer Finance Agencies (1935); Schmus, The Banker's View, 33 Consumer Finance News 6 (Nov. 1948); Section 1 of Proposed Bill under Consideration by New York State Joint Legislative Committee on Installment Financing, introduced with amendments in the 1949 Legislature as S.B. No. 820, and Interim Report of the Joint Legislative Committee on Installment Financing (March 2, 1948); Mors, Rate Regulation in the Field of Consumer Credit, 16 J. of Bus. of Univ. Chi. 51, 124 (1943). For entry of banks into the consumer finance field, see Baird, Commercial Bank Activity in Consumer Instalment Financing, 33 Fed. Reserve Bull. 264 (March 1947); Mors, Commercial Banks and Competitive Trends in Consumer Installment Financing, 21 J. of Bus. of Univ. Chi. 133 (1948); Paddi, The Personal Loan Department of a Large Commercial Bank, 196 Annals 135 (1938).

[4] 35 Fed. Reserve Bull. 300 (March 1949). In classifying consumer installment credit according to types of lenders, the Federal Reserve Board uses the term "small loan companies." The term "consumer finance companies" or "regulated consumer finance companies" is often used to mean the same thing.

A substantial part of the figures for loan credit extended by commercial and industrial banks, is in fact sales finance credit. For comments re the effect of FRB classification procedure, see Dauer, The Place of Consumer Finance Companies in the Consumer Credit Field, 33 Consumer Finance News 4, 5 (Nov. 1948). For other comments on the Federal Reserve statistics, see Dauer, Consumer Credit, the Long View and the Short View, 37 Credit World 4, 6 (March 1949), 30 Great Lakes Banker 14, 24 (March 1949).

[5] The following agencies will not be considered herein: pawnbrokers and remedial or semi-philanthropic loan associations, which are included under "Miscellaneous lenders" above, and credit unions.

Economically, the pawnbroker is on the periphery of the field. The ancient pawn transac-

loan companies,[6] banks, and sales finance companies. Sales financing now accounts for over half of total consumer installment credit. Most if not all of Professor Bogert's conclusions apply with equal force to consumer installment debt arising from the sale of goods and to the creditors in such transactions. The inequality in the bargaining power of the debtors is approximately the same. The urge to acquire goods approaches in impelling power the need for money. The lack of financial sophistication of buyer and borrower, their need for advance disclosures in order to make intelligent decisions, and the inadequacy of their legal remedies are much the same.[7] Possibly of equal importance is the fact that the different types of credit are often equally available at the option of the consumer. The car buyer at the teller's window gets a blue note if he wishes to borrow the purchase price and mortgage the automobile, or a white contract if he decides to buy it on a conditional sale plan. The consumer with $50 in his pocket can use it to pay the doctor and then borrow to buy something, or he can use it to make a down payment and borrow to pay the doctor. It is important to note, however, that installment sales in larger amounts, such as for an automobile, do not involve the same impelling necessity as money for the doctor, and the social consequences of overreaching in the automobile transaction may not be as serious.

Professor Bogert, it is submitted, saw the need not for a small loan

---

tion is not a loan. There is no debt, the res alone being responsible for the amount at stake. Provident Loan Society of N.Y. v. Chambers, 88 N.Y.S. 2d 459 (1949), N.Y. L.J. p. 995, col. 5 (March 18, 1949). In modern times, largely because of statutes, the term "pawnbroker" is sometimes corrupted and applied to pledge loans. Mottershead, Pawn Shops, 196 Annals 149 (1938).

The remedial loan association, while very important socially, has become a static element and quantitatively is a minor factor. Ibid.

The credit union is also a comparatively static institution. Socially, it is of great importance and usually a benefit. Economically, it is the smallest of the consumer credit classes statistically recognized by the Federal Reserve Board. In passing, it should be noted that the Federal Credit Union Act poses an open jurisdictional question of federal versus state regulation of consumer credit. This act purports to grant a greater or different interest privilege to its creatures within many states than is possessed under the state's law by its own citizens or residents. The fixing of interest maxima has always been considered a state police power function. If the federal usurpation is sustained, there is no other basis than the absurd *ipsi dixit* that credit unions created under the act are fiscal agents of the federal government.

[6] The term "consumer finance companies" is now more often used than the term "small loan companies." The term "industrial loan companies" as used in this article includes industrial banks, Morris-Plan banks or companies, and discount companies. These terms are often used almost synonymously.

[7] Section 1 of Proposed Bill under Consideration by New York State Joint Legislative Committee on Installment Financing, introduced with amendments in the 1949 Legislature as S.B. No. 820, and Interim Report of the Joint Legislative Committee on Installment Financing (March 2, 1948); Pa. Motor Vehicle Sales Finance Act § 2, Pa. Stat. Ann. (Purdon, Supp. 1948) tit. 69, § 602; Summary Report of the Joint State Government Commission to the General Assembly of Pennsylvania, pp. 14–20 (March 21, 1947). Compare Clark, Financing the Consumer 227, 235 (1933).

code but for a consumer installment credit code. His thesis called for comprehensive legislation to unify or at least harmonize the regulations within an area of our national life which comprises a social and economic unit.

It should be borne in mind that there is a vital difference between consumer credit extended on installments and all other types of consumer credit. The Federal Reserve Board classifies all consumer credit as installment credit, single payment loans, charge accounts, and service credit.[8] Despite their volume and the great difficulty of classifying single payment loans, charge accounts, and service credit, these types of credit ordinarily do not involve the possibilities of deception and overreaching which are inherent in installment credit. Charges for these credits usually are not high, the bargaining power of the customer is stronger, and the social consequences of overreaching are less disastrous than in the case of installment credits. Nevertheless, the ease with which a consumer installment debt can be disguised as a single payment loan or a charge account will create grave problems in the application of a comprehensive code to consumer installment credit. The impotence of Regulation W in respect to single payment loans illustrates the difficulties to be met.

Whether or not a consumer's debt is repayable in installments is a characteristic upon which the most basic distinctions rest. An installment debt is geared directly to the average consumer's manner of life. It reflects the wage system. The consumer receives his income in periodic increments and his normal expenses are payable in the same manner. The consumer may be confronted with two kinds of financial problems: one is the gradual accumulation of small debts which finally become unmanageable except by a refunding operation; the other is a sudden need for a sum beyond the savings which he has or is willing to use. Whether he gets into debt slowly or suddenly, he can only get out of it gradually. The most typical consumer debt, the obligation which society can feel sure is truly a consumer's obligation, is one repayable in installments.

The installment feature is also very important from the viewpoint of regulation because it lends itself so readily to deception and overreaching, both in soliciting the consumer to become indebted and after he has become a debtor. A principal reason is the readiness with which the average person mistakenly identifies a rate of discount with a rate of interest. In an installment debt the amount of principal of which the debtor has the benefit declines with each payment. A loan of $120, if repaid at $10 a

[8] 35 Fed. Reserve Bull. 300 (March 1949). Out of approximately 16 billion dollars of total consumer credit outstanding on December 31, 1948, the Board assigns $2,902,000,000 to single payment loans, $3,854,000,000 to charge accounts, and $972,000,000 to service credit. That leaves $8,196,000,000, or approximately one-half of the total, to consumer *installment* credit.

month, approximates $60 of principal debt for one year or $120 for 6 months. Six per cent of $120 discounted, that is subtracted at the beginning of the transaction, is equivalent to between 11 per cent and 12 per cent per annum interest. Out of this molehill has grown a mountain of difficulty in regulating consumer installment credit.[9]

The complexities of interest rates in installment credit, combined with the economic weakness of the debtor, necessitate legislation to protect the debtor from deception and oppression.[10] The most important respects in which unfairness to the debtor can occur are, first, in the representations and disclosures made to consumers who contemplate going into debt, then, in the charge exacted for the credit extended, and, finally, in the remedies available to the creditor for collection. Of these three, the rate of charge is the crux.

In view of recent wartime experience, it seems unnecessary to dwell on the variety of subterfuges which can be used to defeat price control. The problem of enforcing price control in the loan field approximates that in other fields. Everyone is familiar with the tie-in sale, the sub-rosa payment to the janitor, or the purchase of furniture to get an apartment, the deterioration in quality, and the reduction in service which can come with price control. The problem in the consumer installment credit field has been to control the price, to prevent evasions, and at the same time keep high standards of service and foster competition. The rate authorized to be charged must be high enough to permit competitive rate reductions and to encourage improved service. Below that point destructive consequences are inevitable.[11]

[9] See notes 29, 30 infra.

[10] Bogert, op. cit. supra note 1. See also note 2 supra. "The unregulated small loan business has in fact produced a chain of evil consequences. Of this, experience has furnished conclusive demonstration. Borrowers have almost invariably been poor people at times of their most exigent needs. Untrained in the refinements of business negotiations, usually ignorant of the existence of usury laws, and incapable of using the rights which the law gave them, they have often fallen easy victims of unconscionable money lenders. The lenders, on the other hand, have generally been persons endowed with a shrewd business sense for profitable opportunities, and in many cases have been more devoid of respect for usury statutes than the more responsible lenders of larger sums. Frequently this has been due not so much to the inordinate greed of lenders, as to the fact that the usury laws assumed risk and expense factors in lending much below those in the small loan business. Whatever its cause, the result has been to subject a considerable body of the public to oppressive and illegal interest exactions. The sufferers have been the economically weak. The conditions under which lender and borrower met lacked that equality of bargaining power essential to just business transactions. That the state has a right to prevent the stronger from pressing his advantage to the point where it entails injurious social results has been recognized by the courts. . . ." F. R. Hubachek (the author's father), The Constitutionality of Small Loan Legislation (1931), reprinted in Gallert, Hilborn, and May, op. cit. supra note 2, at 132.

[11] Sixth Draft of Uniform Small Loan Law, n. 14; Robinson and Nugent, op. cit. supra note 2, at 185–88.

The paramount problem of rate control in consumer installment credit is made more difficult by the devices of the usurer to increase and obscure the real rate of charge. The subterfuges of the usurer are almost infinite but they fall into five classes:[12]

1) Concealment of the fact that the transaction is a loan. In this class fall pretended purchases of property at low prices or sales at high prices, and casting the transaction in the form of a "hazard" agreement.[13]
2) Use of a collateral transaction such as the sale of something to the borrower on which the lender makes a profit, or the use of a third person who exacts something from the borrower for the lender's benefit.[14]
3) Exaction of charges ostensibly for something other than the use of money. Typical examples are "service charges," "fees," "loss reserves," "fines," and "collection expense."[15]
4) In the case of installment loans, discounting the maximum rate of interest permitted by the general usury law with the interest computed on the original amount of the loan for the full period of the contract without regard to the declining principal balances.[16] This device is often accompanied by refusal to refund unearned charges when the loan is refinanced before maturity.
5) Outright fraud, such as filling out blanks falsely, taking two notes, arbitrarily increasing the principal amount or the length of time involved, or failing to credit payments properly, making inaccurate computations, and charging arbitrary fines for defaults.[17]

Statutory regulation in this field will not be effective unless the devices by which the debtor is overreached and oppressed are prevented, in fact not in theory, without curtailing the extensions of installment credit which the consumer demands. In framing such regulation, fortunately, the benefits of over forty years of experience are available through the large scale research and experimentation conducted by the Russell Sage Foundation.

This started shortly after the turn of the century. With the mechaniza-

[12] Hubachek, Annotations on Small Loan Laws, Pt. III (Russell Sage Foundation, 1938), which lists four of the five classes and discusses discounting under the heading "Confusion in Computation" rather than as a separate class of device; Detection of Usurious Claims and Illegal Charges in Wage Earner Bankruptcies, Pt. III (Conference on Personal Finance Law, 1943); Scott v. Lloyd, 34 U.S. (9 Pet.) 418 (1835).

[13] Missouri, Kansas & Texas Trust Co. v. Krumseig, 172 U.S. 351 (1899); People v. Vanderpool, 114 P. 2d 608 (Cal. App., 1941), rev'd on other grounds 20 Cal. 2d 746, 128 P. 2d 513 (1942); State on Inf. of Taylor v. Salary Purchasing Co., 218 S.W. 2d 571 (Mo. S. Ct., 1949).

[14] Fowler v. Equitable Trust Co., 141 U.S. 384 (1891); Jernigan v. Loid Rainwater Co., 196 Ark. 251, 117 S.W. 2d 18 (1938); Searl v. Earll, 62 A. 2d 374 (Mun. C.A. D.C., 1948); Commonwealth ex rel. Grauman v. Continental Co., 275 Ky. 238, 121 S.W. 2d 49 (1938).

[15] Cucco v. Pacific Finance Corp., 259 App. Div. 1033, 20 N.Y.S. 2d 779 (1940); Vee Bee Service Co. v. Household Finance Corp., 51 N.Y.S. 2d 590 (S. Ct., 1945); Kelter v. American Bankers Finance Co., 306 Pa. 483, 160 Atl. 127 (1932); Joy v. Provident Loan Society, 37 S.W. 2d 254 (Tex. Civ. App., 1931).

[16] Vee Bee Service Co. v. Household Finance Corp., 51 N.Y.S. 2d 590 (S. Ct., 1945).

[17] Oyster v. Longnecker, 16 Pa. 269 (1851); see Midland Loan Finance Co. v. Lorentz, 209 Minn. 278, 296 N.W. 911 (1941).

tion of industry, the movement to cities, and the development of the wage system, cash credit in small sums had become a common need.[18] This need was, and still is, more urgent than the desire for credit to purchase goods for which savings will not suffice. The gradual shift in the quality of the small loan problem from a social to an economic basis was not immediately recognized. Small wonder that legislatures continued to deal with it piecemeal and usually by increasingly severe prohibitions.[19] Even now, when mass production has become a basic feature of our economy, supported by the mass consumption of wage and salary earners, we find legislatures lagging—picking at the pieces of a consumer credit system which has become confused by the entrance of widely different and virtually unregulated agencies. As separate institutions, the several types of agencies which grant consumer credit are inhibited in their evolution by their past courses of development. They strive to maintain as long as possible the features which distinguish them from their competitors. The political strength of each has tended to perpetuate an erratic, irrational system of regulation.

The one systematic plan of regulation throughout the period of haphazard legislation has resulted from the work of the Russell Sage Foundation. From 1907 to 1916, the Foundation made a comprehensive study of the whole problem of small credits to individuals. It encouraged the enactment of various types of remedial legislation and observed the results. From 1916, when it published its First Draft of Uniform Small Loan Law, until 1942, when the Seventh Draft was issued, it participated continuously in many states in the process of perfecting the system of regulation and adapting it to changing conditions.[20] By 1916 the Foundation had determined that the regulation of the commercial sources of credit could be accomplished only by relaxing the usury laws and increasing the maximum permitted rate sufficiently to cover the risk and expense of making such

[18] Kelso, Social and Economic Background of the Small Loan Problem, 8 Law & Contemp. Prob. 14 (1941); Mors, Rate Regulation in the Field of Consumer Credit, 16 J. of Bus. of Univ. Chi. 51 (1943); Eubank, A Case Study of the Effects of Consumer Credit upon the Family, 196 Annals 211 (1938); Mottershead, op. cit. supra note 5.

[19] Gallert, Hilborn, and May, op. cit. supra note 2, cc. iii, iv; Robinson and Nugent, op. cit. supra note 2, c. iv.

[20] Nugent, The Changing Philosophy of Small Loan Regulation, 196 Annals 205 (1938); Bradway, The Development of Regulation, 196 Annals 181 (1938). The Seventh Draft, which was published by the Russell Sage Foundation in 1942, resembles the Model Consumer Finance Act which was published by the National Consumer Finance Association, "as approved in principle, October 1, 1948." See the foreword to this publication.

It is noteworthy that the four states which do not have general usury laws have nevertheless adopted the principle of rate control and other regulation of small loans. These states are Colorado, Maine, Massachusetts, and New Hampshire. California may also be listed as being in this class. See Nugent, The Loan-Shark Problem, 8 Law & Contemp. Prob. 3, 12 (1941).

loans and to provide a profit.[21] It was concerned with fostering a legitimate source of consumer credit and with obtaining effective and enforceable regulation of the creditor and his practices, in the public interest. If statutory provisions necessary to accomplish these ends caused the price to be stated in an unattractive form, that either did not concern the Foundation or may have been considered to be an advantage.

The Uniform Small Loan Law has the following principal features: ambit fixed by a maximum size of loan, originally $300; licensing system for lenders; licensees subjected to special penalties and state surveillance; non-licensees who exact usury subjected to severe special penalties; a requirement for detailed statement to the borrower of the salient facts of the loan; compulsory acceptance of prepayments; prohibition of confession of judgment; strict regulation of wage assignments; and prohibition of numerous devices of concealment or evasion, such as false or misleading advertising. Banks, industrial banks, building and loan companies, credit unions, pawnbrokers, and sometimes other special agencies having a statutory background are exempted from the penalties and denied the privileges of the Act. The most important feature of the USLL is the permitted maximum rate. Originally this was 3½ per cent a month computed as simple interest on the declining unpaid principal balances up to $300. Over the years, this maximum rate attracted large amounts of capital. In 1935 the Foundation recommended a reduction to 2½ per cent a month on the portion of the unpaid balance exceeding $100. In 1942 a further reduction was recommended to 3 per cent on the portion of the unpaid balance up to $100 and 2 per cent on any portion over $100.

As Professor Bogert relates, after 1916 statutes based on the USLL were rapidly enacted by many states. Sometimes radical departures from the Uniform Draft occur in state acts, so it is unsafe to generalize as to details, but it is possible to classify the state acts as to their over-all effectiveness. The Act, in workable form, is now in effect in thirty states, Hawaii, and the Dominion of Canada.[22] Deficient and only partially effective versions are in force in four additional states.[23] In sixteen of the

[21] Nugent, The Changing Philosophy of Small Loan Regulation, 196 Annals 205, 207 (1938); Ham, Small Loan Legislation, Progress and Improvement (Russell Sage Foundation, 1922).

[22] Hubachek and Barrett, Reference List of Small Loan Legislation (National Consumer Finance Association, 1948). Since 1944, Missouri has barred special interest statutes by a constitutional provision, and New Mexico has enacted a small loan law.

[23] Nev., N.M., Okla., Wyo. New Mexico was just transferred from the workable list to the defective list because of a 1949 law concerning the sale of life and disability insurance in connection with loans.

Comprehensive small loan laws in four additional states are rendered nugatory by maximum rates of charge too low to permit commercial operations: Ala. (8 per cent); Ark. (10 per cent);

thirty states,[24] some form of small loan law has been in force for thirty years or more; in seven[25] other states, for over twenty years.[26]

The USLL originally controlled the great bulk of the consumer credit which then existed, that is, the small loan to the individual. There were only two lending agencies of considerable significance: the "loan shark" whom it barred and punished, and the licensed lender whom it fostered and regulated. The subsequent development of new and unregulated consumer credit agencies and the entry into the consumer credit business of established but unregulated commercial lenders have created the need for a new and broader code.

It is not contended in this article that the system and standards set up by the USLL are the best for the new agencies. They have been dealt with here because that law constitutes the only available datum point by which to determine the drift of recent legislation.

The most prevalent recent devices to increase ostensible rates of charge on consumer installment credit have been the use of discounts and fees without refunding unearned portions thereof, and the sale of insurance to debtors. A discussion of them will illuminate the background of recent legislation.

Discounting.—The history of the discounting device explains its prevalence and the fact that so many bank and industrial loan laws have legalized it. Originally, the industrial loan companies depended on the fiction of selling the applicant for a loan an investment certificate and applying his installment payments to the purchase price thereof rather than to the principal of the loan. Later, many commercial banks adopted the same plan but put the installment payments in a special account which was

Ga. (1½ per cent per month); Tenn. (6 per cent plus fee not exceeding 1 per cent per month). To these four can be added the District of Columbia, which since 1913 has had a rudimentary small loan law which is inoperative because of a maximum rate of 1 per cent per month. For inadequacy of these rates, see Dumas, Two Anti-Loan Shark Drives (Junior Bar Conference, American Bar Association, 1947); Report of the House Committee on the District of Columbia on Small Loans, 72d Cong. 1st Sess. (1932); Meador, Loan Sharks in Georgia (Junior Bar Conference, American Bar Association, 1948); Special Report for the [Virginia] Corporation Commission of Pertinent Facts with Respect to and Methods of Determining the Rate of Return to the Small Loan Business, pp. 37, 38 (1948); Nugent, Three Experiments with Small-Loan Interest Rates, 12 Harv. Bus. Rev. 35 (1933). The following states have constitutional provisions relating to interest rates which bar enlightened consumer credit legislation: Ark., Okla., Tenn., Tex.

[24] Ariz., Colo., Conn., Ill., Ind., Me., Md., Mass., Neb., N.H., N.J., N.Y., Ohio, Pa., Utah, Va.

[25] Fla., Iowa, La., Mich., R.I., W.Va., Wis.

[26] The remaining seven of the thirty states are: Calif., Idaho, Ky., Minn., Ore., Vt., Wash. The states which have not adopted the uniform law in any form are: Del., Kan., Miss., Mont., N.C., N.D., S.C., S.D., Tex. Missouri in 1927 adopted a law patterned after the uniform law, but it was nullified by the Missouri Constitution of 1945.

not credited to the loan until it equaled the face amount of the note. Both usually took a note which included the full interest in its principal amount, and subtracted (discounted) the interest from the face of the note before giving the borrower the net amount.[27]

Banks and industrial loan companies had to use these methods to obtain a workable rate of charge.[28] They drew back from the blunt and open statement of the actual over-all rate of charge so shocking to the popular "six per cent per annum" concept; thus the discount and the fee were used to augment the lender's income without stating the true percentage rate. With these methods has come a train of abuses requiring corrective measures such as mandatory refunds for prepayment.

Eight per cent discount returns the borrower $92 for a $100 note which requires the repayment of $8.33 per month for a year. Questions at once arise: What is the "amount of the loan" for purposes of solicitation and for computations to determine compliance? What happens when the borrower prepays by cash or renewal? He has contracted to repay, as though it were principal, $8 more than he received. Does he still pay it if he retires his note at the end of five months?

The 8 per cent, so discounted, is slightly under twice that percentage in terms of true interest.[29] If the installment credit is extended for two years, the deduction is 16 per cent, the true rate of charge increases in an even larger ratio, and the need for refunding is correspondingly increased. When prepayment without refund occurs very early in the transaction, the multiplication of the true rate of charge results in a greatly increased percentage rate.

When a fee is added to the discount, the result is the same as though the amount of discount were increased. A 4 per cent fee and an 8 per cent dis-

[27] Consumer Credit 202–7 (American Institute of Banking, 1945); Chapman, Commercial Banks and Consumer Instalment Credit 141–42 (National Bureau of Economic Research, 1940); Saulnier, Industrial Banking Companies and Their Credit Practices 90 (National Bureau of Economic Research, 1940); Harold, Industrial Banks, 196 Annals 142, 143–44 (1938); Younggren, Usury—Evasion Devices—Commercial Banks, 29 Ill. Bar. J. 409 (1941); United States v. Palmer, 28 F. Supp. 936 (N.Y., 1930); Connor v. Minier, 109 Cal. App. 770, 288 Pac. 23 (1930); Columbus Industrial Bank v. Rosenblatt, 111 Conn. 84, 149 Atl. 209 (1930); Mesaba Loan Co. v. Sher, 203 Minn. 589, 282 N.W. 823 (1938); Morris Plan Co. of New York v. Osnato, 123 N.Y. Misc. 428, 204 N.Y. Supp. 829 (S. Ct., 1924); National City Bank of New York v. Levine, 155 N.Y. Misc. 132, 277 N.Y. Supp. 664 (Mun. Ct., 1933).

[28] Mors, Commercial Banks and Competitive Trends in Consumer Instalment Financing, 21 J. of Bus. of Univ. Chi. 133, 135 (1948).

[29] Consumer Credit 223 (American Institute of Banking, 1945) states: "The true, or actuarial, interest rate is based on the amount of principal outstanding (net amount advanced) from month to month. For example, take the $100 personal loan payable in twelve equal monthly instalments which was discounted at $6, or 6% flat. The net amount advanced, or principal, is $94, the actuarial, or true, rate of interest is 11.58% per annum, or 0.965% per month." The mathematical calculations which precisely prove this rate follow this quotation.

count on a 12 months' installment credit create a true rate of charge of 24 per cent per annum. The need for a refund or credit commensurate with the unexpired period of the time originally contracted for is much the same.[30]

It should be noted, parenthetically, that, on the basis of very broad averages, the charges of banks and industrial loan companies for typical consumer installment credit are lower than the charges of regulated consumer finance (small loan) companies. True comparisons, however, are almost impossible because of inherent differences. The average amount of the individual transaction by banks and industrial loan companies is considerably larger than that of small loan companies. The credit worthiness of the average debtor to the former agencies is better. Moreover, the rates of charge by small loan companies fall within a comparatively narrow range so that an average is a relatively true indicator, while the rates of charge of the other two agencies vary widely between different lenders and different customers of the same lender. In a substantial part of the business done by many lenders who use the discount and fee method of charging, fortuitous circumstances such as the incidence of prepayment, refinancing, and delinquency determine the true rate of charge.[31]

That the abuses possible under a discount or a discount and fee system have aroused critical legislative interest is demonstrated by the laws passed during the last four years directed to the subject of refunds of unearned charges written into the amount of the debt at its inception. The simple interest system, not to be written up in advance or taken until earned, automatically eliminates all questions of refund. It will be interesting to observe whether legislatures continue to try to correct an error or stop enacting the error in the first place. The answer probably lies in the question of how firmly the discount and fee system is embedded in our traditions and financial institutions. That is another way of saying, how important is it to conceal the true percentage rate of charge on consumer installment credit?

Insurance.—Insurance has become a popular feature in connection with installment credit, both because it provides protection to the lender and the borrower in case the security is destroyed or the borrower dies and be-

[30] Interim Report of the [N.Y.] Joint Legislative Committee on Installment Financing (March 2, 1948); Summary Report of the Joint State Government Commission to the General Assembly of Pennsylvania, p. 17 (March 21, 1947); Phelps, Monopolistic and Imperfect Competition in Consumer Loans, Journal of Marketing 382, 389 (April 1944); Agostini v. Colonial Trust Co., 36 A. 2d 33, 39 A. 2d 406, 44 A. 2d 21 (Del. Ch., 1944). Some of these studies show that the problem of adequate refunds is also inherent in sales finance transactions where the "credit price" includes in its original face all credit charges and often others such as insurance.

[31] Mors, op. cit. supra note 28, at 146.

cause it can be a source of an extra and hidden profit. The profit may come to the lender as a commission for selling the insurance or as a rebate of part of the premium or as a favorable "experience rating." When insurance is required for the purpose of obtaining a charge in addition to the maximum legal interest rate, it is a device to evade the law.

There are three elements which make the sale of insurance by installment creditors a puzzling problem of regulation and enforcement. First, since insurance is frequently a bona fide requirement of the creditor or a bona fide desire of the debtor, it is often difficult to determine whether its use is a subterfuge. Second, if the debtor really needs insurance, there is theoretical justification for permitting the lender to sell it, provided the premium, the commission, and the coverage are standard. Third, if the use of insurance is to any extent a subterfuge, it is difficult to regulate because of the lack of a definite standard of bona fide values for the various types of insurance coverage which may be provided.

Suffice it to say that the use of insurance sales by consumer installment creditors presents today a most serious threat to any systematic plan of regulation in the public interest. Evasions of rate maxima by that device strike at the base of credit regulation.

The more obvious examples of insurance sales to increase creditors' profits are "credit life insurance" and "credit health and accident insurance," available only in connection with consumer credit. Generally, they are sold through the creditor or his affiliate to most of the customers and the commissions are one-half or more of the premiums. The premiums for life, health, and accident coverage combined are about $7.50 for each $100 of a debt payable over one year.

Even among stringently regulated small loan companies the matter of insurance sales has been a battlefield of opposing philosophies, mainly because of the difficulty of separating the good from the bad. One school says, "The borrower will have to buy insurance to obtain a loan secured by his car; why shouldn't the lender be permitted to sell him standard coverage at standard rates and get the profit?" The other school says, "Well and good if there was any way to be sure that only such sales as you describe are made, but everyone knows that if they are permitted there will be unconscionable abuses difficult to detect and impossible to prevent. Moreover, a great part of the gross income of the lender will be his undisclosed commissions. He will advertise only a part of the true rate of charge. The free and honest competition which is the consumer's salvation will revert to a battle of creditors' wits in which the slickest will win. Complete and candid disclosure is the *sine qua non* in consumer credit."

The honest and necessary element of insurance has been prostituted until the corrective legislation may overshoot the mark as widely as the abuses have exceeded the true need. Recent laws on the subject of insurance sales show a continuation of the effort to confine the consumer creditor's charges to those disclosed in his published rate.

The early legislation regulating the installment loan activities of commercial banks and industrial loan companies effected little change in their practices. Most industrial loan or industrial bank acts have been based on the use of discounts and sometimes fees.[32] Recent acts legalizing the entry of commercial banks into the consumer loan business have usually permitted the same practices,[33] but often safeguarded by restrictive provisions. As bona fide installment sales are free of the usury laws,[34] the credit charge and other items are added to the cash sale price of the goods, and recent sales finance acts permit this practice.

Laws enabling and sometimes regulating these lending agencies were generally drafted by the agencies themselves. Under these laws the total actual charge for the credit is stated in several parts, obscuring the amount as well as the rate of charge. The early laws were procured merely for the purpose of relaxing the usury maxima. The need of regulation to protect the borrower was not at first recognized. It was only after experience under relaxation of the usury laws without regulation that the necessity for controls of creditors' practices became apparent. Recent regulation has been in the form of a more definite statement of the maximum rate, refund of unearned charges upon prepayment, a more specific statement of the amount of service fees, limitations on the service fee, and prohibitions of extra charges. In some recent instances, supervision in the form of licensing and inspection has been provided for.

A review of the legislation which was passed in the years 1945–1948 reveals that twenty-one states have enacted one or more significant regu-

[32] Industrial Banking Legal Digest (Consumer Banking Institute, 1945).

[33] Twenty-three states have statutes under which banks may make installment loans at a greater rate of interest and charges than permitted by their general usury laws. Sixteen of these apply only to banks. Seven are not restricted to banks but are available to certain other lenders making installment loans. Seventeen of the twenty-three were enacted during or since 1936. The twenty-three states are: Ala., Ariz., Del., Fla., Ga., Iowa, Ky., Md., Mich., Minn., Miss., Neb., N.J., N.Y., N.C., Ohio, Pa., S.C., Tex., Va., W.Va. ,Wis., Wyo. In addition, three states (Conn., Me., Mass.) have specifically authorized savings banks to make "personal loans."

[34] Provided, of course, that the course of dealing does not make the vendor a mere agent for the sales finance company in extending the credit. For exemption of installment sales from the usury laws, see Berger, Usury in Installment Sales, 2 Law & Contemp. Prob. 148 (1935); Rogers, Sale of Property on an Installment Payment Basis, 10 Time Sales Financing, No. 2, pp. 7–9, 26 (1945); Annotation: Finance charge in connection with conditional sale contract as usury, 143 A.L.R. 238 (1943).

latory laws applicable to some part of consumer installment credit. These enactments fall under three general headings: acts enlarging the area of the small loan law; acts regulating other types of creditors in a manner similar to small loan laws; other evidences of a trend toward symmetrical treatment of the various credit agencies and methods.

Acts Enlarging the Area of the Small Loan Law.—The $300 size limit on loans to which the small loan laws usually apply was first adopted about 35 years ago. Recognizing the decrease in the value of the dollar and other factors, four states increased the size of loan to which their small loan laws apply from $300 to $500,[35] thus re-applying these laws to the part of the consumer credit field to which they originally applied.

Five states enacted small loan law amendments or revisions of varying importance.[36] Two other states replaced inadequate and fragmentary small loan laws with new laws which made little if any improvement.[37]

Acts Which Regulated Banks, Industrial Loan Companies, and Others in a Manner Similar to Small Loan Laws.—Under this heading are included laws requiring refunds of unearned charges, restricting or regulating the sale of insurance, and subjecting sales finance companies to regulations heretofore ordinarily imposed only on lenders.

a) *Bank and Industrial Loan Laws.* Thirteen states enacted one or more laws regulating banks or industrial loan companies. In seven states, nine laws related to banks.[38] In nine states, ten laws related to industrial loan

[35] *Illinois:* Ill. L. 1947, p. 1152. *Michigan:* Mich. Pub. Acts 1947, No. 130. *New Mexico:* N.M.L. 1947, c. 174. *New Jersey:* N.J.L. 1948, c. 71. For 1949 legislation see note 60 infra.

[36] *California:* Cal. Stat. 1945, cc. 1220 and 1221 (loans over $5,000 exempted from important restrictions), 395, 396, and 902 (commissioner's discretionary powers strengthened). *Connecticut:* Conn. Pub. Acts 1945, c. 456 (loans limited to 18 months, and interest rate reduced after 20 months to 1 per cent a month; refinancing of balances unpaid after 20 months prohibited). *Massachusetts:* Mass. Acts 1946, c. 119 (small loan rate reduced to 2 per cent a month), 174, 223 (small loan rate a year after maturity limited to 6 per cent a year). *Utah:* Utah L. 1945, c. 15A, Utah Rev. Stat. Ann. (Supp. 1947) Tit. 7, c. 8a, §§ 7–8a–1 to 7–8a–24 (revised small loan law; right to require and sell insurance on a restricted basis granted). *Virginia:* Va. L. 1946, c. 335 (commissioner authorized to reduce small loan rate).

[37] *Alabama:* Ala. Gen. Acts 1945, No. 159. *Wyoming:* Wyo. L. 1945, c. 128, Wyo. Comp. Stat. (1945) c. 39, art. 11, §§ 39–1111, 39–1112.

[38] *Iowa:* Iowa Acts 1945, c. 213, Iowa Code (1946) §§ 529.1 to 529.13 (new installment loan law: $2,500 loan limit, authorized charge of $6 a year per $100, or 1 per cent a month, refunds required, advertising regulated). *Kentucky:* Ky. Acts 1946, c. 60, Ky. Rev. Stat. (1948) § 287.215 (new installment loan law: $5,000 loan limit, rate of $6 per $100 per year on first $2,000 and $5 per $100 on balance, refunds required, charges except fines and recording fees prohibited). *Massachusetts:* Mass. Acts 1945, cc. 197, 407, Mass. Ann. Laws (1948) c. 168, § 54 (savings banks permitted to make personal loans up to $1,000 at rates to be approved by commissioner). *Minnesota:* Minn. Stat. (Mason, Supp. 1946) §§ 7774–71 to 7774–75 (new installment loan law: $500 loan limit, 6 per cent a year discount and $3 minimum charge permitted, refunds required, charges for defaults, recording, and insurance allowed, loan statement required); Minn. L. 1947, c. 314 (loan limit increased to $1,500). *New Jersey:* N.J.L. 1945, c. 208 (refund required); N.J.L. 1948, c. 67, art. 12 (revised law: loan limit raised from $1,000

companies.[39] In each case the legislation was a step toward codification, as it either regulated a portion of the field which had not been regulated before or it added new restrictions to existing regulations. Generally, the restrictions added to existing laws reflected experience under enabling acts which had originally been adopted without regard to the consequences of increasing the maximum rate without applying adequate regulations.

b) Sales Finance Laws. Six states and Quebec enacted laws concerning the sales finance business. Five were regulatory laws where none had existed before.[40] One was a provision for an interim study committee.[41] One was both a provision for an interim study committee and a provision for interim legislation which has been continued twice.[42]

Of the five sales finance laws enacted, all required a refund except that of California. The New York interim legislation for the benefit of banks and industrial loan companies required the charges to be computed on unpaid balances subject to a minimum charge of $5, and the report of the

---

to $2,000). *New York:* N.Y.L. 1946, c. 88 (refund requirement for banks, industrial banks, and credit unions). *Pennsylvania:* Pa. Stat. Ann. (Purdon, Supp. 1948) Tit. 7, § 819–1001 (new installment loan law: 6 per cent a year discount on loans up to $3,500 permitted, refunds required, fines, insurance, recording, and attorney's fees permitted, advertising which states charges required to include payment chart or statement of rate).

[39] *California:* Cal. Stat. 1945, c. 1494 (industrial finance charges changed from discount and fee method to monthly percentage on unpaid balance method, change-over completed from discount and fee method which began in 1940, Cal. Stat. 1940, c. 34, and Cal. Stat. 1941, c. 1187). *Delaware:* Del. L. 1945, c. 237 (amount of discount permitted under 6 per cent discount law limited to 18 per cent [three years]). *Maryland:* Md. L. 1945, c. 932, Md. Ann. Code (Flack, Supp. 1947) art. 11, §§ 153 to 195 (new law: discount and fee on loans up to $1,500 permitted). *Minnesota:* Minn. L. 1945, c. 439 (refund required). *New York:* see note 38 supra. *Pennsylvania:* Pa. L. 1947, No. 288 (loan limit increased from $1,000 to $2,000, interval between fees reduced from 8 to 4 months). *Texas:* Tex. L. 1945, cc. 194 and 195 (oblique recognition of typical industrial bank operation). *Utah:* Utah. L. 1945, c. 73 (repetition of service fee oftener than 6 months prohibited); Utah L. 1947, c. 62 (industrial loan companies permitted to write automobile insurance during interim period of 2 years). *Wisconsin:* Wis. L. 1947, c. 462, amending Wis. Stat., c. 115 (very old Discount Loan Law revised: loan limit raised from $1,000 to $2,000, discount rate lowered, fee added, provisions requiring certificate of convenience and advantage eliminated).

[40] *California:* Cal. Stat. 1945, c. 1030 (fragmentary motor vehicle sales finance act providing maximum rate and some disclosure). *Connecticut:* Conn. Gen. Stat. (Supp. 1947) cc. 215h and 233 (installment sales up to $2,000 regulated, no maximum rate, disclosure and refunds required). *New Jersey:* N.J.L. 1948, c. 419, N.J. Rev. Stat. (Supp. 1948) §§ 17:16B–1 to 17:16B–12 (installment sales up to $3,000 regulated, no maximum rate, disclosures and refunds less $10 acquisition charge required). *Pennsylvania:* Pa. L. 1947, No. 476 (stringent motor vehicle sales finance act, following recommendations of Joint State Government Commission [bills to create consumer credit commission failed]). *Quebec:* 11 Geo. VI, c. 73 (1947) (minimum down payment, refunds, and disclosures required, maximum charge fixed).

[41] *Michigan:* Sen. Con. Res. No. 14, 3d spec. sess. (adopted April 26, 1948).

[42] *New York:* Sen. J. Res. (adopted March 17, 1947); N.Y.L. 1947, c. 487 (banks, trust companies, and industrial banks authorized to charge 12 per cent a year on unpaid balances or a minimum of $5 on purchase of installment paper arising from sales of personal property), extended by N.Y.L. 1948, c. 219 and N.Y.L. 1949, c. 494.

New York interim committee recommended legislation to require refunds in connection with all sales finance transactions.[43] There are now sales finance laws of varying comprehensiveness in at least eleven states.[44] Most of them require refunds and disclosure of the more important facts of the transaction, such as the down payment, the finance cost, and the monthly payments required. Some have other important features, such as maximum rates, licensing, and restrictions on dealer participation.

c) Refund Requirements. The most noteworthy legislative development during this period has been recognition of the need for a refund requirement when the statute permits interest or other charges to be taken or written into the principal balance in advance. The necessity for refunds arises largely from the fact that consumers are prone to refinance their debts one, two, or more times before getting out of debt. Loans are made generally for 12, 18, or 24 months, and the charge, when taken or written into the principal balance in advance, is for the full term of the loan. If the borrower refinances his loan after six months, a failure to refund results in a greatly increased rate of charge. Of course, if charges are taken only after having been earned, there is no need for refund.

Refund requirements of varying effectiveness have been added to existing laws authorizing increased rates to banks and industrial loan companies. They have also been included in new laws restricting sales finance companies, even when the law did not set a maximum rate. They have not been added to the laws regulating small loan companies because, with minor exceptions, all small loan laws require charges to be computed and paid on the unpaid balances at the time of each payment, and prohibit discounting or taking charges in advance or compounding.

In eight states, bank or industrial loan legislation has required a refund of unearned charges when the loan is prepaid in full.[45] New York imposed the refund requirement on commercial banks, industrial banks, and credit unions in the same amendatory law. Pennsylvania imposed refund requirements on banks, industrial loan companies, and sales finance companies in separate laws enacted about the same time. Minnesota enacted separate refund laws for banks and industrial loan companies. Except for

[43] Ibid. Interim Report, op. cit. supra note 30.

[44] In addition to those listed note 40 supra these are: *Indiana:* Ind. Stat. Ann. (Burns, 1933), §§ 58-901 to 58-934. *Maine:* Me. Rev. Stat. (1944) c. 56, § 264. *Maryland:* Md. L. 1941, cc. 476, 851. *Massachusetts:* Mass. Ann. Laws (Supp. 1948) c. 255. *Michigan:* Mich. Stat. Ann. (Henderson, Supp. 1947) §§ 9.1482, 19.415(1) to 19.415(14). *New York:* N.Y. New Personal Property Law (McKinney, Supp. 1948) § 64a. *Wisconsin:* Wis. Stat. (1947) § 218.01.

[45] Cal. (industrial loan companies); Iowa (banks); Ky. (banks); Md. (industrial loan companies); Minn. (banks and industrial loan companies); N.J. (banks); N.Y. (banks and industrial banks); Pa. (banks). See notes 38, 39 supra.

Texas,[46] no legislation which authorized an increased rate of charge for installment loans failed to impose either a refund requirement or a requirement for computing charges on unpaid balances. Of the eight states enacting refund legislation, five[47] added the requirement to existing laws, indicating that experience had demonstrated the need for it. The refund amendment to the California Industrial Loan Act[48] shifted the basis of the charges from the discount and fee to the unpaid balance method, but with permission to pre-compute the charge subject to a refund requirement.

Three states imposed a refund requirement by administrative regulation.[49]

Three states either eliminated service fees or restricted the right to repeat a service fee in connection with refinancing.[50] Several states authorized fees, but under restrictions limiting repetition of the charge in connection with refinancing.[51] Elimination or restriction of a service fee is the same type of reform as a refund requirement.

d) Insurance. Three states enacted insurance laws of general application, prohibiting lenders and finance companies from requiring customers to purchase insurance from a designated insurance agent as a condition of the transaction.[52] These laws treat all classes of lenders alike for the purpose of the restrictions which they impose—further evidence of a trend toward codification. Laws or amendments of at least three states, however, authorized the requirement and sale of insurance on a restricted basis.[53]

e) Advertising. The Illinois honest advertising statute was amended to apply specifically to loans, credit, and interest as well as merchandising. The amendment was similar to a New York amendment adopted in 1940.[54]

Other Evidences of a Trend toward Symmetrical Treatment of the Various Credit Agencies and Methods.—A clear instance of this trend was provided when refund requirements were imposed "straight across the board" in New York in one amendatory act which applied to several different portions of the consumer credit business. Another evidence of codification is the new Wisconsin Consumer Credit Review Board, established by a stat-

[46] See note 39 supra.

[47] Cal., Minn., N.J., N.Y., Pa. See notes 38, 39 supra.

[48] See note 39 supra.

[49] Del., Ind., Utah.

[50] Cal. and Utah (industrial loan laws); N.M. (small loan law).

[51] Md., Pa., and Wis. (industrial loan laws).

[52] *Michigan:* Mich. L. 1947, Act No. 67. *New Jersey:* N.J.L. 1948, c. 298. *New York:* N.Y.L. 1947, c. 153.

[53] Md., Utah, and Wis. (industrial loan laws; see note 39 supra); Utah (small loan law; see note 36 supra).

[54] Ill. L. 1945, p. 680; N.Y.L. 1940, c. 356.

ute requiring industry representation of three branches of the consumer installment credit field.[55]

Most of the legislation authorizing charges either prohibited all charges in addition to those specifically authorized or enumerated carefully defined exceptions, thus closing the door to a variety of subterfuges to defeat the rate maximum. As most small loan laws have always done this, the tightening of other types of laws has tended to reduce the differences in treatment.

Developments in three other states further illustrate this trend toward similarity of treatment:

a) *Indiana*. Consolidated rate hearings for small loan companies, industrial loan companies, sales finance companies, and pawnbrokers, together with other unified administrative action in Indiana recognized the desirability of treating the installment credit agencies on as nearly as possible a comparable basis. The trend toward uniformity was further evidenced by the fact that administrative regulations applicable to small loan companies were decreased and those applicable to other installment credit agencies were increased. In addition, the 1947 Legislature provided for a commission to be appointed by the Governor to make a general study of the installment credit business.[56]

b) *Missouri*. The new Missouri constitution is a dramatic illustration of an effort to force codification. Missouri is now under a constitutional necessity to codify its interest laws and treat all classes of lenders substantially the same for the purpose of statutes fixing maximum interest rates. The effect of the new constitution was to destroy all existing legislation authorizing rates of interest in excess of the general maximum, 8 per cent a year, fixed by the usury law. Missouri has been without a small loan law or any other regulatory interest law based on lender classification since July 1, 1946, when the new constitution became effective. The Missouri legislature has been unable to solve this problem despite a steady succession of bills in regular and special legislative sessions beginning in 1945.[57]

c) *Kentucky*. Kentucky limited pawnbrokers' charges to 3½ per cent per month computed as simple interest on unpaid principal balances.[58]

[55] Wis. L. 1947, c. 411.

[56] Industrial Loan & Invest. Reg. No. 1 (adopted Nov. 30, 1945); Ind. L. 1947, c. 391.

[57] Mo. Const. (1945) Art. III, § 44; Household Finance Corp. v. Shaffner, 356 Mo. 808, 203 S.W. 2d 734 (1947); State on Inf. of Taylor v. Salary Purchasing Co., 218 S.W. 2d 571 (Mo. S. Ct., 1949).

[58] Ky. Acts 1946, c. 216; Ky. Rev. Stat. (1948) §§ 226.050(2), 226.080, 226.090, 226.990(4). A recent case involving this law suggests that pawnbrokers have a constitutional right to a rate of charge adequate to remain in business. Peel v. Dummit, 214 S.W. 2d 605 (Ky. App. Ct., 1948).

This record of recent legislation can be summed up in three general propositions: by slow and faltering steps society is bringing consumer creditors toward a harmonious system of regulation; the strongest emphasis is on the maximum charge the creditor will be permitted to take; and advancement toward a code of regulation has been forced by legislative recognition of isolated evils. The opinion is added that many additional single steps must be taken toward unification of the diverse regulatory measures which now apply to the different consumer creditors, before a scientifically conceived code will appear which will have a reasonable chance of understanding and adoption.

In recent years certain significant non-legislative trends have also appeared. Small loan companies have expanded the portion of the consumer credit field in which they operate by increasing their loan sizes substantially above $300. This was partly the result of the increase in wage and price levels and partly for competitive reasons. Loan sizes have increased not only in states where the maximum size under the small loan law has been increased above $300 but also in other states where larger amounts can be lent under other laws. In at least eleven states, small loan licensees conduct an affiliated business of lending in amounts over $300 under such other laws. These eleven states, plus the eight states which permit larger loans under the small loan law, make nineteen states in which a larger loan business can be conducted.[59] Two more states, Connecticut and New York, were added to the list as of July 1, 1949, as the result of 1949 amendments increasing the ambit of their small loan laws from $300 to $500.[60]

The above development is only one example of the overlapping and intermingling of consumer credit agencies. Similarly, most commercial banks which extend consumer credit do so on both a lending and a sales finance basis. This has been characteristic of banks since the early 1930's when they began to enter the field in large numbers.[61] Another example is the fact that several of the larger and many of the smaller sales finance companies have obtained small loan licenses. Similarly many industrial

[59] Small loan laws: Cal. (no loan limit); Ill. ($500); Mich. ($500); Neb. ($1,000); N.J. ($500); N.M. ($500); Ohio ($1,000); Wash. ($500). Hubachek and Barrett, op. cit. supra note 22.

Industrial loan and other laws: Ariz., Colo., Ind., Md., Mass., N.H., Ore., Pa., R.I., Utah, Wis.

[60] Conn. L. 1949, Act No. 136; N.Y.L. 1949, c. 521.

[61] See consumer credit statistics in 35 Fed. Reserve Bull. 300–1 (March 1949), and similar statistics in prior Bulletins, which list commercial bank installment credits outstanding according to purpose of credit and whether it is sales credit or direct loans. See also note 4 supra.

loan companies have sales finance departments. Some of the larger small loan companies and many of the smaller ones (and even a few credit unions) are in the sales finance business to some extent.

The so-called dual business clause of the USLL has been an important factor in the development of overlapping activities. As conceived by the Russell Sage Foundation in 1932, this clause was designed to prevent the small loan business from being operated as an adjunct of another business when the combination facilitated abuses, e.g., credit furniture stores and collection agencies. The clause prohibited a small loan licensee from engaging in any other business in the licensed office, except with the permission of the supervising official upon a finding that the joint operation would not facilitate evasion.[61]

This clause has been applied usually as a prohibition, but, more recently, it has been used as a regulation. The operation of the small loan business, the industrial loan business, and the sales finance business—all in conjunction with each other and in the same office—has been permitted under varying degrees of administrative restriction. The Model Act of the National Consumer Finance Association recognizes the right to conduct several businesses in the same office subject to reasonable administrative restrictions.[62]

The administration of the dual business clause in Wisconsin is an example of its use not only as a regulatory measure but also as a means of bringing unified standards into play. Since 1944 the Commissioner of Banks has required small loan licensees to agree in writing to conform to certain regulations as a condition to obtaining permission to engage in other businesses. Under this administration, those licensed under the discount law were for a time required to state the discount charge on a basis as nearly as possible comparable to simple interest rates. When the discount law was recently amended to permit a fee, the agreement was revised to require a refund of the fee as a condition to refinancing a discount loan under the small loan law.

From the record it seems clear that there has been a drift toward the standards of the USLL in (1) imposing some degree of regulation on other

[61] Fifth, Sixth, and Seventh Drafts of Uniform Small Loan Law § 12.

[62] Section 12(a) of the Model Consumer Finance Act, op. cit. supra note 20, reads: "The business of making loans under this Act may be conducted within any office or place of business in which other business is solicited or conducted unless the Administrator, after 10 days' notice to the registrant and opportunity to be heard, finds that such conduct facilitates or conceals violations of this Act and orders the registrant to desist from such conduct, but the registrant shall not be denied the right to conduct such business in an office or place of business in which there is conducted any business of a financial nature supervised by any state office or official."

consumer credit agencies, (2) requiring refunds of charges taken in advance, (3) restricting the creditor's power to make hidden profits, and (4) forcing advance disclosure of salient facts to prospective debtors. Another trend is in the direction of enlarging the field of the small loan law by increasing the maximum size of loan to which it is applicable. Thus it appears that there has been some progress toward symmetrical treatment of the various credit agencies and methods, piecemeal and forced by circumstances rather than conceived and executed by the foresight of legislative statesmen.

Certain important considerations are often overlooked in dealing with the problems of rates and regulations for consumer installment credit. There is a widely held belief that small loan laws are an extraordinary if not unique exception to the general usury laws. This misconception may partially account for the legislative reluctance to deal realistically with the increased rate of charge required by consumer installment credit agencies. In fact, many other important types of credit agencies and transactions are excepted, some of which are entirely unregulated.[64]

The degree to which a general interest maximum must be relaxed to permit a consumer installment credit business to be carried on varies inversely with the size of the individual credit, whether the debt is a loan or a sale obligation. Within reasonable limits there is a fixed overhead cost of every loan which varies only slightly with the size of the loan. Obviously, at a fixed rate the dollar return on a large loan is greater than that on a small loan. A loan of $100 repaid in twelve equal monthly installments of principal at an interest rate of 2½ per cent per month on unpaid principal balances returns to the lender $16.25 of gross income, while a loan of $500 on the same terms returns $81.25. Assuming that the overhead costs of the creditor are $15 per loan, it is apparent that he cannot make a $50 loan at a direct profit and that the profit on the $500 loan is too large.

Similarly, the degree to which the average debtor needs statutory protection varies inversely with the size of the individual credit. Though this is more elusive, it is a fact equally as important as the inverse relationship

[64] Barrett and Ulrich, op. cit. supra note 2, at v–vi say, "The small loan law is one of several well-established exceptions to the general usury laws. In some states there are so many statutory or judicial exceptions that in practice the general usury law effectively limits only the exceptional lender or transaction. The more important types of lenders and loans which frequently are wholly or partially exempt from usury laws include banks, credit unions, industrial or discount loan companies, building and loan associations, pawnbrokers, installment loans, small loans, loans insured by the Federal Housing Administration, loans to corporations, and demand or call loans exceeding $5000 secured by negotiable instruments. Other important types of credit transactions are exempt from usury laws on the technical ground that they are not loans of money, such as a sale of property on credit with an increase over the cash price, and purchase of accounts receivable."

between the necessary percentage charge and the size of the individual credit. By and large the degrees of necessity, unsophistication, and inadequacy of legal remedies decrease as the size of the consumer's credit transaction increases. On the occasions when the constitutionality of the USLL has been challenged,[45] the principal question has been whether the special provisions of that law, which are applicable only to a special class of transactions (loans of $300 or less), constitute a reasonable exercise of the police power. In answering this question, the appropriateness of the provisions to correct the evils existing in the special class of subject matter is the criterion. The courts have uniformly found that loans of less than some stated dollar amount are characterized by peculiar attributes calling for special protection of the debtors. While $300 or less has been judicially determined to be an appropriate means to define the class, the question is essentially one of degree, in which the elements requiring state intervention actually shade from black to white by imperceptible stages. There is some point, however, within the proper zone for consumer installment debt regulation, at which the emphasis of regulation should shfit and the maximum permitted rate of charge should change. There may be several such points between the smallest consumer debt above the charity line and the largest consumer debt below the business line.

The growth of consumer debt into transactions of the larger amounts has complicated the problems of state regulation. Assuming that the line between the two classes of consumer installment debt falls today somewhere between $500 and $750, effective regulation of the smaller class can differ radically from that of the larger class of debts. The smaller class has special characteristics. Here are found the borrowers who are closest to the subsistence level. Generally they are the group most easily imposed upon, both because of lack of reserves upon which they can draw to assert whatever rights the law gives them and because they are most lacking in business experience and judgment. Also, these are the borrowers who are most apt to become public charges if they are imposed upon by creditors. The community has more than an ordinary interest in their protection.[46]

[45] People v. Stokes, 281 Ill. 159, 118 N.E. 87 (1917); Kelleher v. Minshull, 11 Wash. 2d 380, 119 P. 2d 302 (1941), and cases cited; Hubachek, op. cit. supra note 12, at 16–26 (citing cases).

[46] Kelso, op. cit. supra note 18; Cobb, Consumer Credit as It Comes to the Legal Aid Society of New York, 196 Annals 198 (1938); Eubank, op. cit. supra note 18.

Typical conditions where small loans were unregulated were described by one court as follows: "The population of Jefferson county is estimated to be 365,000, of which about 50,000 or 60,000 are wage-earners, with between 200,000 and 300,000 dependents. To live and support their families they require an extension of credit upon peculiar terms to meet their needs and abilities to pay. They occupy rented property; the rent payable by the week. The county is the center of extensive industries, commerce, manufactures, transportation, retail and wholesale businesses. There are within the county between 70 and 80 small cut-rate loan offices, en-

In this smaller loan class, it is essential to bar the outright loan shark by careful definitions and heavy penalties. That need is less in the larger class. Comparatively strict surveillance by a state official is indicated in the smaller group. Certain minor devices of evasion which are likely to be practiced on the unsophisticated small debtor must be dealt with specifically in the smaller transactions, but such provisions may be waived or modified for the larger ones. Discretionary licensing provisions may be moderated for lenders engaged mainly in the larger transactions who can be counted on to make the smaller loans at comparatively low rates.

Another element distinguishes the two classes of consumer debt—the arithmetical effect of a high rate of charge. The escalation of the true rate of charge which is caused by discounting or compounding 6 per cent per annum is not nearly as rapid or as burdensome as the same practices would produce at 18 per cent or 24 per cent per annum. A fee of 1 per cent of the loan may be taken much more frequently than one of 4 per cent with less cumulation of the resulting true rate of charge. The safeguards which must be thrown around the comparatively low rate of charge necessary for a $750 credit can be less stringent than in the case of the higher rate necessary for the smaller credits.

These factors point toward two types of consumer installment credit regulation, based on the same essential protective principles but differing markedly in detail and in the elaborateness of the precautions. As the use of consumer installment credit has penetrated into the larger amounts per transaction, the states have frequently confused the need for less regulation with a justification for no regulation. That omission characterized the period of about fifteen years prior to 1940, during which the newer installment credit agencies entered the field. The last eight years, however, have seen legislative recognition of the need for regulation in these areas.

The difficulties of harmonizing, let alone unifying, the diverse institutions, methods, and practices of consumer installment creditors seem obvious. It has been suggested that this is a task for those responsible for

---

gaged in making weekly and periodical loans, payable in installments on charges varying from 15 per cent per annum to 200 per cent per annum. The total loans of such offices annually exceed $1,000,000. It is disclosed by the record that in 1929, 18,000 actions were instituted in the court of one justice of the peace of Jefferson county; 8,000 in another during a period of six months; 23,000 in the court of one justice of the peace in 1931; 73,000 actions were commenced, tried, and judgments rendered in the courts of the justices of the peace in 1931; 30 writs of forcible detainer were issued in one day, and approximately 2,000 garnishments in one month in 1932." Shaw v. Fox, 246 Ky. 342, 55 S.W. 2d 11 (1932).

For oppression of small borrowers, their economic weakness, and inequality of bargaining power, see also note 2 supra; Simpson, The Small Loan Problem of the Carolinas 79 (Presbyterian College Press, Clinton, S.C., 1941); Report of the Interim Committee of the House of Representatives, Minn., Small Loan Legislation, p. 16 (1929).

our Uniform State Laws and our Restatements. The American Law Institute and the National Conference of Commissioners on Uniform State Laws have been working for the past several years on a proposed uniform commercial code containing a division on secured commercial transactions with a subdivision on consumer credit. In a recent article,[67] it is pointed out that this would be embarking on a field of social legislation and that there may be considerable doubt as to the propriety of including such regulation in a statute relating to security concepts. The author refers to this area as a battleground in which it would be necessary to take into consideration not only the business of sales finance but also of personal finance:

> This will create problems galore. Just to mention a few, with respect to small loan and industrial bank regulations, what of rates and what of a licensing provision, which in many states is almost a matter of grace on the part of administrative officials, where licenses can be granted only on the ground of public convenience and necessity? In the sales finance field, a full and complete disclosure of price and terms to the buyer and specified redemption rights are certainly unobjectionable from anyone's viewpoint; but here what of delinquency charges, rates, rights to a deficiency, absolute possessory rights on default and refunds? Uniformity of opinion on all of these various aspects of such regulation is completely lacking.

The author has not overstated the confusion or the difficulties inherent in a consumer credit code.

Nevertheless, the task is a challenging one. Certainly the subject is of national importance and the need is increasing. On February 14, 1949, the Chairman of the Board of Governors of the Federal Reserve System made a statement before the federal Joint Committee on the Economic Report, a portion of which was a plea by the Board to be given power to regulate consumer credit, presumably in only its broadest economic aspects. Even giving weight to the fact that it was in a bureau's request for additional prerogatives, it is illuminating to compare some of the statements made with the universally disparaging public attitude toward consumer credit during the formative period from 1910 to 1930:

> Instalment credit is the volatile and dynamic element in consumer financing. It is subject to wide fluctuations and exerts a pervasive effect on consumer demand and prices. . . . Consumer instalment credit, furthermore, is directly associated with the distribution and financing of durable goods. . . . Thus instalment financing is subject to a growth force that is basic and persisting and is becoming a more important element in the economy.[68]

[67] Ireton, The Proposed Commercial Code: A New Deal in Chattel Security, 43 Ill. L. Rev. 794, 804 (1949).

[68] Statement on Behalf of the Board of Governors of the Federal Reserve System before the Joint Committee on the Economic Report (Feb. 14, 1949), presented by Chairman Thomas B. McCabe (p. 6 of leaflet insert to Fed. Reserve Bull., Feb. 1949).

If that is true, it seems inevitable that our legislative processes will continue to work toward the imposition of a systematic plan of regulation covering all consumer installment credit agencies in a manner which holds them to uniform standards of conduct consistent with the public interest. Recent progress is in that direction although it has been fumbling and erratic. In due course, after enough parts of the subject matter have been dealt with separately, the basis will exist for the comprehensive scientific treatment which Professor Bogert called for in 1944.

NONTESTAMENTARY ACTS AND INCORPORATION BY REFERENCE

ALVIN E. EVANS*

IT IS generally acknowledged that the usual statute of wills requires that a testamentary disposition comply with certain formalities. Thus a valid will must be in writing, signed or subscribed by the testator, and attested by two or more witnesses. The complete realization of the testamentary scheme, however, often makes it necessary to give some consequence to acts and events extraneous to the will. Several different—although frequently confused—doctrines exist whereby such a fulfillment of the testator's purpose may sometimes be achieved. This paper will analyze the manner in which the more important of these doctrines have been applied by the courts and will suggest possible alternatives to the confusing approach with which the text writers in the past have provided the courts.

The distinction between the doctrine of incorporation by reference and that of nontestamentary acts, or, as Professor Scott prefers to say, "acts having independent significance," has given rise to much speculation during the last quarter of a century. In the second edition of his casebook on property, Professor Gray introduced the subject, "Incorporation by Reference," with the following note:

> The power of a testator to incorporate writings into his will by reference is a subject so closely connected with the power of a testator to make provisions in his will which are dependent on his own future acts that some cases on this latter subject are included in this subdivision.[1]

However, only one case of the latter character was given, and it dealt with advancements to be made in the future which were to be deducted from the legacies created in the will. It thus appears that the concept of the nontestamentary act received little or no development at the hands of Professor Gray. Professor Chaplin indicated that there was no problem in this field save for the determination of the rules for incorporation by reference.[2] A later writer, Professor (now Judge) Dobie, while contenting himself generally with the traditional requirements of incorporation, went on to distinguish that doctrine from "the use of extrinsic documents to

* Dean Emeritus, University of Kentucky College of Law.

[1] 4 Gray, Cases on Property 99 (2d ed., 1906).

[2] Chaplin, Incorporation by Reference, 2 Col. L. Rev. 148 (1902).

establish a testamentary trust."[3] Unfortunately, Professor Dobie stated that "any discussion of the latter topic [was] beyond the scope of [his] article." He then proceeded to discuss under the heading of incorporation the fact that certain arrangements in writing, made by the testator subsequent to the making of the will, might determine the identity of the beneficiary, and that such arrangements were not in violation of the statutory requirement of an attested writing.

Inasmuch as it is believed that it is a socially desirable policy to permit the testator's intention to be realized whenever possible, it is not surprising that in recent years the area of subsequent arrangements to which testamentary significance will be given has been expanded. It should be clear that, while a writing not in existence at the execution of the will cannot be incorporated, not even metaphorically, it may sometimes be given effect as a nontestamentary act of independent significance. To state the distinction briefly: By incorporation by reference, a writing not attested and subscribed in conformity with the statute may be metaphorically included in a will if, by the provisions of the will, the writing is both referred to as being in existence and intended to be included. By the concept of a nontestamentary act, on the other hand, either a legacy or a legatee may be identified by an act or event, occurring either before or after the execution of the will, which must have a significance separate from the testamentary disposition. For instance, if all beneficiaries must be accurately described and fully identified as of the date of the execution of the will, a testamentary contingent remainder could not exist. No testator could provide for his unborn grandchildren. Thus, when it is realized that future events not susceptible of incorporation by reference may determine either the legacies or legatees, a way is opened for the idea that if the event by which the beneficiaries or the property devised is to be identified is not under the control of the testator, the event has independent significance and is accordingly nontestamentary in character. Since the event does not happen for the purpose of implementing the will the policy underlying the requirement of the Statute of Wills is not applicable. Even though the future act is within the testator's control, it does not appear that such an act should be denied effect if the testator did not thereby intend to supplement his will.

The entire problem of giving the testamentary scheme its fullest effect can perhaps best be viewed by an examination of the various rationales

[3] Dobie, Testamentary Incorporation by Reference, 3 Va. L. Rev. 583 (1916). My own article, Incorporation by Reference, Integration and Nontestamentary Act, 25 Col. L. Rev. 879 (1925), came next in point of time.

adopted by the courts in relation to the idea of the nontestamentary act. Such events or acts may be recognized in various combinations throughout the cases, but all of them fall into one or more of the following classes:

a) Uncontrolled events not dependent upon the testator's volition, as, for example, "to such children of my son as shall hereafter be born," or "to such woman as shall hereafter marry X."[4]

b) Future acts of the testator performed for a purpose independent of the will, as, for example, a provision for deducting future advancements from legacies made by will. The testator may also determine the beneficiaries to be identified in the future by his own acts, in concert with acts of others, as, for example, a gift to his partners existing at his death, or to his employees who are such at that time, or to such person as shall care for him in his last years. The later advancement as well as the contract have independent significance apart from the will.

c) The testator may transfer securities to a trustee under a trust scheme to which additions are to be made by his will. The trust scheme is frequently alterable and revocable and subject to being modified by later inter vivos settlements. These later additions may either precede or follow the will. In the first instance, they are not merely created or performed for a purpose independent of the will, but may also be incorporated by reference. The fact that they are incorporated does not prevent them from having at the same time an independent purpose. If they are made subsequent to the will, as is to be shown later, still they were created for the purpose of modifying an earlier trust, or if no earlier one exists, they were created for an independent purpose. A prior settlement subsequently altered may reasonably be regarded as identical with one which is wholly subsequent.

I. The Dilemma of the Fowles Case: The Writings of Another Person

The written acts of another person may have independant significance and thus qualify the testator's will. For example, if A gives his property to such persons as shall be the beneficiaries of B's will, it is difficult to argue that B made his will in order to implement A's will. The uncertainty as to the beneficiaries of A's will is not measurably greater than it would be if the gift were to B's heirs. A power of appointment, however, created in A's will, to be performed by the testamentary act of B, would be, when exercised by B, an act performed for the purpose of implementing A's will and the appointment is valid.

[4] 3 Rest., Property § 348, comments c to f (1940).

The famous New York case of *Matter of Fowles*[5] arose out of this problem of whether the will of another person may be considered as a nontestamentary event by which the beneficiaries of a given will could be identified. The testator and his wife were about to sail on the Lusitania. In view of the dangers of ocean travel, each executed a will. The testator wished to leave part of his property to the beneficiaries of his wife's will, and to this end he conferred on his wife the "power to dispose of the said property by last will and testament duly executed by her." He provided for the possibility that this provision of his will might fail due to their death in a common disaster, by stipulating that in such an event he should be deemed to have died first.

If the testator intended to create a power of appointment, and only a power formula appears applicable, then the power must fail since it was not created prior to its exercise. It seems only fair, however, to interpret the provision so as to give effect to the obvious intent of the testator. To follow the wish of the testator that part of his property go to the beneficiaries of his wife's will, a court is not required to go very far afield. Here a gift on condition may be construed as a trust if a trust interpretation will accomplish the intent of the testator-settlor.[6]

It is not clear what rationale Cardozo relied on in upholding the will in the *Fowles* opinion. However, he talked about incorporation as if that doctrine were applicable, indicating that the difficulty consisted of getting around the New York rule against incorporation by reference, the ambiguities of which will be discussed below. In commenting on the case, Professor Scott was, at least earlier, of the opinion that the wife's will could not be said to constitute an act with independent significance inasmuch as the husband's will contained a power of appointment which could not be exercised before it was created by the will at the time of his death. "It would seem," says Scott, "that since the testator did not provide that his property should be disposed of as his wife . . . should appoint, the decision can not be upheld on this ground."[7] Professor Scott stated, however, that the case might be "supported . . . on the ground that incorporation by reference to the will of another is permitted even though incorporation by reference of other instruments is not permitted and even though the will referred to was not necessarily in existence at the time of the execution of the testator's will." The view that the case could not be supported on the principle of the nontestamentary act has also

[5] 222 N.Y. 222, 118 N.E. 611 (1918).

[6] Woodward v. Walling, 31 Iowa 533 (1871).

[7] Scott, Trusts and the Statute of Wills, 43 Harv. L. Rev. 521, 552 n. 85 (1930).

been recently expressed,[8] although Dean Rowley[9] and Professor R. R. Powell[10] take the position that it is not impossible to construe the wife's will as a nontestamentary act.

It is not apparent from his later treatise whether Professor Scott has now changed his position with respect to the *Fowles* case. He does not cite the case under incorporation by reference, nor does he use it under the section on acts of independent significance.[11] Nevertheless, he appears to break down facts of independent significance into additional types, such as "disposition by will in accordance with *inter vivos* trust," and "disposition in accordance with directions of a third person." The *Fowles* case is cited under the latter heading. He observes that the "result makes good sense."

It seems to this writer, however, that Professor Scott does not reach the "good sense" result by careful analysis. Perhaps he would urge that to insist upon a tag is unduly mechanical and conceptualistic. It would be easier for the courts to reach a "good sense" result if the rationale to be applied could be clearly stated by the text writers. The concept of incorporation has a great deal of utility which should not be destroyed by the exception that a will can be incorporated into another will, when at the time of incorporation it may not have been in existence.

Professor Bogert applies a doctrine that is "somewhat similar, though distinct, [from incorporation], which permits the use of informal evidence outside the will to supplement the will as to the description of the donees or the property given."[12] The statute requires that the will be in compliance with the formalities discussed above; and, thus, if the will is insufficient and needs to be supplemented by an additional writing not attested, there is perhaps no adequate reason why a subsequent list prepared by the testator should not suffice. Professor Bogert's approach, however, leaves the matter largely to the discretion of the courts. It seems inadequate, in view of the alleged adherence to the statute of wills, to say merely that such evidence is admissible to show the position and state of mind of the testator and thus to complete an incomplete will. Professor Scott has offered an alternative in his statement that a will, a sealed instrument, or one attested and subscribed, may be incorporated without violating the statute and without leaving the matter entirely at the discretion of the

[8] Wills—Incorporation by Reference—Comparison with Secret Trusts and Acts of Independent Significance, 46 Mich. L. Rev. 77, 83 (1947).

[9] Rowley, A "Relaxation of the Requirement of Self-sufficient Integration," 6 U. of Cin. L. Rev. 295 (1932).

[10] Report of the Law Revision Commission of New York for 1935, at 444.

[11] 1 Scott, Trusts §§ 54.1, 54.2 (1939). [12] Bogert, Trusts and Trustees § 106 (1935).

courts. In fact, the comment has been made that this is an area where certainty is neither possible nor perhaps desirable; that there may for good reason be a blurring of the concepts of incorporation and nontestamentary acts.[13] It is submitted that a loose analysis is not helpful to busy courts. Such a blurring of these two concepts is neither necessary nor useful, even though it has manifestly occurred in New York and perhaps Ohio.

The comment cited above is excellent in its presentation of the confusion in New York. The general rule against incorporation is still maintained there. If the act identifying the beneficiary is a writing, such as a properly executed will or deed, the New York courts speak loosely of incorporation though the will or deed be a future act. Thus in the recent case of *Matter of Comey*,[14] where the reference was "to such of the descendants of Miriam Comey Adams . . . as she may by her last will and testament designate and appoint," it seems unjustifiable for the court even to mention incorporation by reference. Had the rationale of the nontestamentary act been utilized, the court need have found no violation of the New York rule.[15] The tenor of the New York decisions is confusing to say the least.[16] While the rule against incorporation is said to be in effect, it is not followed in the case of a future will or an inter vivos trust which is neither alterable nor revocable. Thus the New York courts, by allowing the incorporation of arrangements made subsequent to the will, seem to have misunderstood the distinction between nontestamentary acts and incorporation by reference.

The necessity of employing the doctrine of nontestamentary acts is peculiarly observable in its frequent use in the case of distributions to "employees at my death" or "to my partners" or "to those who shall have cared for me in my last illness."[17] The courts usually approve its application in those cases, although they do not define it. There is in fact no effective substitute unless the testator wishes to accomplish his purpose by an inter vivos trust. Thus a legacy to a person who should be living with the will-maker as her companion is good.[18] Even in New York, where the doctrine of nontestamentary acts has never been adequately explored,

[13] Incorporation by Reference, op. cit. supra note 8, at 77.

[14] 173 Misc. 377, 17 N.Y.S. 2d 949 (1940).

[15] Matter of Rausch, 258 N.Y. 327, 179 N.E. 755 (1932).

[16] Matter of Comey, 173 Misc. 377, 380, 17 N.Y.S. 2d 949, 953 (1940).

[17] Incorporation by Reference, op. cit. supra note 8, at 79, n. 17, 18, 19.

[18] Allan v. Brown, 61 R.I. 56, 199 Atl. 753 (1938); In re Hollingsworth's Estate, 37 Cal. App. 2d 432, 99 P. 2d 599 (1940); Howe v. Sands, 141 Fla. 813, 194 So. 798 (1940); Oggier's Estate, 153 Pa. Super. 216, 33 A. 2d 439 (1943); for a recent English case, see In re Keen (1937) 1 Ch. 236.

this type of case is frequent.[19] It is difficult to understand why this particular issue must be threshed over again and again in judicial decisions.

II. Trust Settlements, Incorporation, and Nontestamentary Acts

In the *Fowles* case, the court spoke loosely of incorporation by reference, appearing to make a special exception to the New York rule where the so-called incorporated instrument was a will, though it was not necessarily in existence when the incorporating will was made, and was referred to in words of the future. Some years later, the New York rule respecting incorporation was more severely tested by the *Rausch* case,[20] where a prior nonrevocable and inter vivos trust had been created and was referred to in the will and identified. Again the court talked about incorporation, saying that the rule against it would not be carried to "a drily logical extreme." In both these cases it is believed that the New York rule need not have been violated. A different rationale was possible. If one analyzes the concept of the nontestamentary act so that theorizing along this line becomes familiar to the courts, something will have been done to relieve a patently difficult situation. There are five fairly recent cases which are worthy of comment.

The first one here presented is *In re Jones*,[21] an English case. The testator gave a legacy to a certain investment trust company, as trustee "appointed *or to be appointed* under special declaration of trust . . . executed and bearing even date with this my last will and testament *or any substitution* therefor or *modification* thereof or *addition* thereto *which I may hereafter execute*." (Italics added.) The deed of trust was in fact in existence and identified. Must the declaration of trust fail because a later substitution was possible? The court noted three situations, the first involving incorporation, the second arising where an attempt is made to modify the will by documents not yet written, and the third, the type of problem occurring and becoming increasingly frequent, where an existing document, such as a trust instrument, is referred to and which is expressly made alterable and perhaps revocable.

The *Jones* case was of the third type, and the court believed there were two alternatives before it, either to admit incorporation of the document in existence at the time and disregard the provision for alteration and substitution, or to hold that the whole provision failed. It was decided that

[19] See In re Menken's Will, 180 Misc. 656, 44 N.Y.S. 2d 164 (1943); In re Collier's Estate, 45 N.Y.S. 2d 773 (1943); In re Utter's Will, 173 Misc. 1069, 20 N.Y.S. 2d 457 (1940).

[20] Matter of Rausch, 258 N.Y. 327, 179 N.E. 755 (1932).

[21] [1942] 1 Ch. 328, [1942] 1 All E.R. 642.

the possibility of substitution and alteration was as much a part of the testator's expressed intention as was the remainder of the present existing document, and hence, since a court's chief purpose is to carry out the testator's intent if possible, it could not accept the first alternative. The court thought that there might be a distinction between a document referred to "unless he should substitute another" (but did not) and the present case.

An editorial note in the All England Reports[22] points out that there is a real difficulty in the law of wills where the testator has founded a charity which he anticipates he will develop during his lifetime. He is naturally not anxious to tie it down to a trust deed which may turn out to be quite unsuited to its state of development in a few years' time. Neither does he desire to set out the terms in his will. As things now stand, if he wants to modify the settlement after the date of his will, he is obliged to execute an incorporating will or codicil later.

The English courts and text writers seem never to have identified by a category or tag the concept of the nontestamentary act. Jarman and Williams are wholly unconscious of any problem outside that of incorporation by reference, though some commentators have noted the comparable problem of secret or one-half secret trusts.[23]

Similar to the *Jones* case is *President and Directors of Manhattan Co. v. Janowitz*.[24] The case shows how cautious a lower New York court is in extending "exceptions" to the denial of incorporation by reference. The case is similar to *Matter of Rausch*[25] save that the trust agreement was not only amendable but in fact was amended three times, twice prior to the date of the will and once thereafter. The widow, beneficiary, attacked the theory of incorporation and claimed the property under the residuary clause. The court restricted the consequences of the *Rausch* case to its particular facts and reaffirmed the New York position on incorporation generally. An amendable settlement cannot be incorporated.[26]

This case perfectly illustrates the perplexities confronting an inter vivos settlor-testator mentioned above in the *Jones* case. A man desires to develop a scheme of disposition of his property by establishing a trust in

[22] [1942] 1 All E.R. 642.

[23] In re Boyes, 26 Ch. D. 531 (1884); Blackwell v. Blackwell, [1929] A.C. 318; R.E.M., 59 L. Q. Rev. 23 (1943).

[24] 260 App. Div. 174, 21 N.Y.S. 2d 232 (1940).

[25] 258 N.Y. 327, 179 N.E. 755 (1932).

[26] The case was noted at various stages in 39 Col. L. Rev. 1256 (1939); 26 Corn. L.Q. 172 (1940); 50 Yale L.J. 342 (1940). See Incorporation by Reference-New York Modification, 10 Fordham L. Rev. 82 (1941).

his lifetime, but as the future is unknown and likewise the variations in his fortunes, he makes an alterable and revocable transfer in trust, relying on his reserved power to change it. The will may or may not be the last document involved in the scheme. If it is the last act, it may well incorporate (save in some states) the prior settlements. If he desires, however, to make a subsequent variation in the trust deed, he would be required not only to alter his previous dispositions but also to republish his will. The large number of cases which have arisen shows that this difficulty is not fanciful. Why should not the court hold that the subsequent alteration was an act having independent significance? What additional risk of fraud is involved? In fact, there is a greater risk in the cases involving containers, future charges, or determination of the beneficiaries by future contracts. Yet all of these extraneous factors are given consequence in determining the testator's intent. No new theory is needed here if the courts will bear in mind the wide variety of situations to which the rationale of the nontestamentary act can be applied. In fact, a very important development in this direction may well be looked for so long as it is currently believed that it is a socially desirable policy to permit a settlor's desires to be fulfilled whenever possible.

In *Koeninger v. Toledo Trust Co.*,[77] a settlor created an alterable trust, then executed a will incorporating the trust agreement, and expressly provided that the administration of the residue of his estate passing under the will should be conducted according to the terms of the trust. Thereafter, he made an alteration in the trust agreement by directing that certain land be held for the benefit of one nephew and $500 be shifted to another nephew. The plaintiff beneficiary took the view that the original trust was incorporated, but that since this trust was modified after the date of the will, a merger of the two resulted and the whole trust agreement became a subsequent instrument incapable of incorporation. It was held that though the original settlement was incorporated, such property as was conveyed by it was subject to reassignment under the later trust, but that the land which passed under the will and not by an inter vivos conveyance could not be thus reassigned to an additional beneficiary. This later trust could not directly modify the will.

It is believed that the court reached a sound result in holding that the settlor in making an additional gift of land had, in effect, attempted to alter the will rather than the prior trust. Sustaining the alteration by

[77] Koeninger v. Toledo Trust Co., 49 Ohio App. 490, 197 N.E. 419 (1934); noted in 21 Corn. L.Q. 492 (1936), 49 Harv. L. Rev. 498 (1936). The briefs for both sides are worthy of study.

which an additional beneficiary of $500 was inserted by deed also appears sound. It is clear that if the land had been conveyed in the original trust agreement, and not by the will, an alteration could have been made by the later trust. A testator can thus modify the effect of his will either by a later testamentary document, or by a removal of property by way of ademption. It is difficult, however, to follow the court when it says that the "power to vary the original trust agreement was waived by the incorporation of it into the will." The court might very well have looked upon the later addition of a beneficiary as a nontestamentary act so that the sum assigned could have been paid out of any funds in the trustee's hands. A more simple solution would have been to execute a codicil to the will rather than to attempt to modify the trust agreement.

In the fourth case, *Bolles v. Toledo Trust Co.*,[28] the trust purpose had been worked out and there was an intimate connection between the alterable settlements and the will. The first or original trust inter vivos in this case has no significance for the purpose of this discussion. The second inter vivos transfer in trust was made prior to the execution of the will. Its close connection with the will was shown by the fact that the deed transferred only $4,000 in value while it was charged with the payment of $500 per month from the income to the testator's widow. If the income should prove insufficient for that purpose, the trust agreement authorized an invasion of the corpus. Although the will had been executed subsequent to the trust agreement, both instruments had been drawn up as part of the same general transaction. The will contained a residuary clause which gave the residue to the same trustee mentioned in the trust instrument, and passed sufficient property so that it would become possible to effectuate the provisions of the trust deed. This deed was, however, held by the court to be illusory so far as it affected the widow, because of the high degree of control retained by the settlor, and because of the fact that there was no relation between the value of the securities transferred and the demands made upon them.

A third settlement which transferred additional securities worth $80,000 to the same trustee was made subsequent to the execution of the will. This sum was to be administered in accordance with the earlier inter vivos trust. It was conditioned to the effect that if the widow should disclaim the provisions made for her under the will, the trust was to terminate and all benefits to her were to be cancelled. The point of the case for our purpose seems to be that the court's main attention was directed to the question whether the earlier trust was necessarily incorporated into

[28] 144 Ohio St. 195, 58 N.E. 2d 381 (1944).

the will and whether the settlement subsequent to the will could be regarded as an act of independent significance. The conclusion appears to have been that one procedure was exclusive of the other, and no clear understanding of the latter question was indicated. The independent significance doctrine was not applied.

The last case is *Fifth-Third Union Trust Co. v. Wilensky*,[29] also from Ohio. The settlor settled $500 on the trustee by deed, making detailed provisions for the beneficiaries, specifying the terms of administration, and reserving the powers of alteration and revocation. Since this was but a very small sum settled on the trustee, it is evident that the scheme was to be expanded by other transfers and by will. The will subsequently expanded and completed the scheme of distribution first set out in the deed. Thereafter, by a later deed, the original trust was revoked. It was held that the earlier deed was incorporated and so was unaffected by the revocation.

Unless this result is necessary on principle, it seems to be in conflict with the proposition that a settlor can modify or revoke a gift made in trust if he reserves the power to do so when the trust is created. That this outcome is contrary to the one intended appears manifest. Though the will cannot be revoked technically by the nontestamentary revocation, yet the subsequent acts of the settlor may affect the application of the will. Just as a subsequent conveyance of Blackacre will destroy the prior devise of it, so the subsequent nullification of the terms of the trust under the reserved power removes the basis for the operation of the will, and the will fails not because it was revoked directly, but because the terms for its operation were effectively cancelled by an act having independent significance. The effect on the will was merely consequential. There appears to be no adequate reason for the argument that this rationale would cause an undue risk of upsetting wills validly created. The policy which would avoid the result reached by the court seems clear.

It would appear that recent developments in inter vivos trust-will cases involving the possible application of incorporation and also the nontestamentary act are unsatisfactory. Incorporation is so firmly established in Ohio that it is applied whether or not the testator's general scheme is thereby promoted. If the scheme of disposition contemplates the possibility of future acts after the date of the will, incorporation fails and so does the entire plan. These cases presumably represent the law in England, New York, and Ohio. The doctrine of independent nontestamentary acts is not yet understood.

[29] 70 N.E. 2d 920 (Ohio App., 1946); see Incorporation by Reference—Comparison with Secret Trusts and Acts of Independent Significance, 46 Mich. L. Rev. 77 (1947).

III. The Incorporation of Deeds

A father desires to make a fair distribution of his property, and, not wishing to postpone the undertaking entirely until his death, deeds to some of his children portions of his land. He may wish to retain a life interest for himself, but instead of inserting such a provision in his deeds, he simply retains possession of the deed until his death. At that time he has disposed of the balance of his property by will, carefully avoiding a devise of the land which was the subject of his deed. In many cases he explains the dispositions made in his will by saying that he has already conveyed certain lands to certain children, and he shows an intent to avoid what would otherwise be an unequal distribution.

By the great weight of authority, the land which could not pass inter vivos for lack of delivery of the deed, does not pass to the grantees as devisees under the doctrine of incorporation of the deed by reference. It is said that the deed, though adequately identified, cannot be incorporated because there was not an intent to incorporate it.[30] The testator meant that the land should pass by deed rather than by will, and no intention can be imported into the will which is not expressed in it.

Thus, if the testator disposes of the residue "not heretofore deeded away by me" and the deed is inoperative as a conveyance, it is nevertheless not incorporated into the will.[31] So if he says, "I give to my son 'in addition to what I have given him by deed,' " there is said to be no incorporation of the contents of the deed.[32] Similarly, if a testator expressly declares an intention to make an equal distribution and, to effectuate it, refers to his prior deeds, there is still no incorporation.[33]

The courts have been astute to show that such language does not result in a gift by implication. In order to imply a gift, the two references to the subject matter must be in the same instrument and not by separate deed and will.[34] The question of incorporation may be raised where the action

[30] Bottrell v. Spengler, 343 Ill. 476, 175 N.E. 781 (1931); see In re Young's Estate, 123 Cal. 337, 55 Pac. 1011 (1899); 1 Scott, Trusts § 56.1 (1939); 1 Bogert, Trusts and Trustees § 103 (1935).

[31] Chambers v. McDaniel, 28 N.C. 169 (1845).

[32] Bailey v. Bailey, 52 N.C. 35 (1859).

[33] Witham v. Witham, 156 Ore. 59, 66 P. 2d 281 (1937); Stodder v. Hoffman, 158 Ill. 486, 41 N.E. 1082 (1895). Cf. Allenbach v. Ridenour, 51 Nev. 437, 279 Pac. 32 (1929); Koger v. Koger, 29 Ky. L. Rep. 687, 92 S.W. 1167 (1906); Noble v. Tipton, 219 Ill. 182, 76 N.E. 151 (1905); Benson v. Hall, 150 Ill. 60, 36 N.E. 947 (1894); Hunt v. Evans, 134 Ill. 407, 25 N.E. 579 (1890).

[34] Smith v. Smith, 113 Md. 495, 77 Atl. 975 (1910); Benson v. Hall, 150 Ill. 60, 36 N.E. 947 (1894); Harris v. Harris, 3 Ir. R. Eq. 610 (1869). But cf. Holton and Huckley v. White, 23 N.J.L. 330 (1852); Marsh v. Hague, 1 Edw. Ch. 174 (N.Y., 1831).

is one to set aside a deed, delivered after the maker's death, for fraud in obtaining it. The fact that the deed is specifically referred to in the will does not help the grantee in such cases.[35]

In Arkansas, where incorporation by reference is not recognized, it was held in the case of *O'Leary v. Lane*[36] that the deeds could be referred to for purposes of identification of the land if they were sufficiently designated. This seems to be an obscure way of saying that although the deed may not be incorporated, it may have independent significance if one can be sure of its identity. In the *O'Leary* case, the deeds had not been delivered, and the court declared that the deeds were not adequately identified for incorporation. The words of the will were:

> It is my will and desire that the deeds heretofore by me executed to the heirs of my estate, deeding to them real property that I desire each to have at my death, which are now in my safety deposit box in the Farmers' and Merchants' Bank . . . be by my executor . . . delivered to said heirs mentioned in said deeds, which property I give and bequeath to each of said heirs as conveyed in said deeds.[37]

Four deeds to four grantees were found in the designated container. It appears that such identification should be quite sufficient for incorporation in even the most exacting states which recognize the doctrine. Further, the testator also devised the lands which he had intended to convey. It seems a travesty to hold that the gifts must fail for lack of identification.

In Massachusetts,[38] a testator executed a conveyance and put the deed into his chest. By will he gave to the beneficiary the chest and its contents. The devise failed. Thus, by a mechanical application of the requirement of delivery, the plain intent of the testator was frustrated. A deed directed to be delivered under a will is not delivered until too late and therefore is not incorporated into the will. In another case, an injunction was granted to prevent the delivery of a deed after the death of the maker, though the will referring to the deed showed clearly that the testator meant to retain the land within his estate until his death.[39]

There has been all along, however, a dissent which has waxed encouragingly with the years. In 1865, in a Pennsylvania case,[40] a testator had executed a conveyance of certain land to his sister, but had not delivered

[35] Zimmerman v. Hafer, 81 Md. 347, 32 Atl. 316 (1895); cf. Hunt v. Evans, 134 Ill. 496, 25 N.E. 579 (1890).

[36] O'Leary v. Lane, 149 Ark. 393, 232 S.W. 432 (1921). Compare 1 Bogert, Trusts § 106, at 347 (1935): "The reference to the deed is not for the purpose of incorporating. . . it into the will, but merely to describe the legal and equitable donees under the will."

[37] O'Leary v. Lane, 149 Ark. 393, 398, 232 S.W. 432, 433 (1921).

[38] Parrott v. Avery, 159 Mass. 594, 35 N.E. 94 (1893).

[39] Richardson v. Byrd, 166 S.C. 251, 164 S.E. 643 (1932).

[40] Thompson's Executors v. Lloyd, 49 Pa. 127 (1865).

the deed. In his will he devised to her certain lands together with the other lands which "I have already conveyed by deed to her." This was held to constitute an incorporation. Following this precedent, a lower Pennsylvania court held in 1939 that when a testator declared in his will that since he had already deeded, he did not devise the lands in question, the grantee-devisee took under the will.[42] It is observable that although the testator declared that he did not intend to devise the land, a devise is the only method by which the intent can be effectuated. Indiana also has held that an undelivered deed, referred to in a later will, was incorporated, since the testator showed his intention to pass title at death only.[43]

The best discussion of the matter is found in a recent Nebraska case.[44] The testator recited in his will that he had already deeded a certain tract of land to his wife's niece "and for that reason I do not devise any real estate to her." The deed not having been delivered, the question of construction was whether she could take by either deed or will. The testator had expressly negatived any intent to transfer by will, and the deed as such was ineffective. Great hardship was shown to result if the devise should fail and there was no doubt of his intent that she should have the land. The deed was held to have been incorporated. Thus the court avoided a mechanical, conceptualistic interpretation and carried out the testator's intent, which can fairly be read into the language of the will.

This result has been approved by commentators.[44] It has been suggested that this outcome could be reached either by the theory of incorporation, or as a gift by implication, or by the doctrine of constructive delivery of the deed.[45] If one applies the theory of incorporation, he must omit the formal requirement of an intent to incorporate. He will have to urge that a formal and actual intent is not required if in fact incorporation is to be allowed in order to accomplish the testator's evident purpose. The language used may be interpreted thus: "I have given my son Blackacre by deed and I therefore do not devise it to him. If, however, I had not already conveyed it to him, I would now devise it to him." That, I

[42] Hogue's Estate, 135 Pa. Super. 543, 6 A. 2d 108 (1939); cf. Hourigan v. McBee, 130 S.W. 2d 661 (Mo. App. 1939); Arrington v. Brown, 235 Ala. 196, 178 So. 218 (1938); White v. Reading, 293 Mo. 347, 239 S.W. 90 (1922); Sharp v. Hall, 86 Ala. 110, 5 So. 497 (1889).

[43] Mortgage Trust Co. v. Moore, 150 Ind. 465, 50 N.E. 72 (1898). See Jennings v. Reeson, 200 Mich. 559, 166 N.W. 931 (1918). In Loring v. Sumner, 23 Pick. 98 (Mass., 1839), the testator declared in his will that he had given his son $1,000 by note as his full share of the estate. The note was invalid but the court interpreted the language as creating a legacy.

[44] In re Estate of Dimmitt, 141 Neb. 413, 3 N.W. 2d 752 (1942).

[44] Ibid., noted in 41 Mich. L. Rev. 751 (1943); 37 Ill. L. Rev. 425 (1943); 22 Tex. L. Rev. 87 (1943).

[45] 22 Tex. L. Rev. 87, 92 (1943).

think, could be construed as a gift by implication. Looked at in this light, the inferences may be said to arise from the will.

In spite of the argument that there can be no implication save where the inferences arise within the same instrument, it appears that there are analogies which might lead to a gift by implication in these cases. Thus, where there has been a revocation by a mistake clearly appearing on the face of the will, a revocation will not be enforced. It is true that by the doctrine of dependent relative revocation there is a distinction between failing to do an act through mistake, and failing to undo one for the same reason. In the latter case, however, the revocation has occurred in form and we wish to learn what effect should equitably be given to it. So, in the principal case, the deed appearing by incorporation into the will is not revoked within the same will by the mistaken declaration that the testator does not therewith devise the land to the grantee. There is no reason why both incorporation and gift by implication may not be available to the interpreter.

In a recent Nevada case, *In re Garrison's Estate*,[46] it was held that a bequest should be implied in the will.[47] The testator recited in his will, "My estate amounts to about $6,000 after the deduction of $700 for my wife, which I have signed papers to prove." A statement appeared in the record that a settlement between the testator and his wife had been made by which she was to receive $700. It may be that the court, if pressed, would have admitted that the written statement about the settlement was sufficiently identified by the reference to it in the will.

IV. Future Memoranda

A testator may contemplate supplementing his will by a future memorandum or descriptive list.[48] This procedure seems to be distinguishable from 1) interpreting language as of the date of death, and perhaps from 2) the container cases in which no verbal amendment is contemplated and no evidence is admissible with respect to the act of adding to or subtracting from the contents of the container, and the legatee gets the final residue. It is also distinguishable from 3) a subsequent act or trust settlement which gives significance to the will but is not done or does not happen for that purpose. Thus, in *Gibbon's Will*,[49] the testator directed that

[46] 59 Nev. 302, 91 P. 2d 818 (1939).

[47] Compare In re Smith's Estate, 46 Misc. 210, 94 N.Y.S. 90 (1905), where it was held that a statement in a will that "I want [B] to have an equal share with my brothers and sisters after all my debts are paid" resulted in a bequest by implication to the brothers and sisters.

[48] Hastings v. Bridge, 86 N.H. 247, 166 Atl. 273 (1933).

[49] In re Gibbon's Will, 234 App. Div. 153, 254 N.Y.S. 566 (1931).

any checks made by himself and outstanding at his death should be treated as valid claims. This case seems somewhat analogous to each of the three distinguished doctrines. The checks issued after the execution of the will resemble subsequent memoranda, but were probably not made for the purpose of altering the will directly, and any evidence of the testator's secret purpose should not be admitted. The court refused to allow claims based on the checks so issued.

The charging of future debts and legacies on land, which once was approved, is also analogous. This was done at the time when devises had to be attested and subscribed, but legacies did not (the period between the Statute of Frauds and the Wills Act). Thus, a charge on land of a legacy, having been created, was upheld though the legacy might be later set up.[50] An American court has sustained a provision for future charges for board and room to be deducted from a legacy.[51] The amount of the yearly deduction was fixed in the will, the only uncertain thing being the number of years for which the charge would run.

The classic requirements for incorporation are that the writing must be presently existing and must be referred to as existing and be identifiable.[52] It is often said also that the will must expressly show the testator's intention to incorporate the separate writing. This requirement is illustrated particularly in deed cases and has been developed more fully above. Suppose the will refers to a future instrument which, however, comes into existence prior to the execution of a codicil. The codicil bringing the will down to date, and without reference to the future writing, still uses language of the future. Some courts have thought that it was not necessary in such a case to insist upon the requirement of reference to any existing instrument if the incorporated paper was clearly indicated.[53] If such writing is unmistakably identified, it seems rather mechanical it is argued to insist upon a reference to its present existence.

V. Containers

It is the common practice to associate the bequests of all items found in containers (where the contents may change from time to time and the containers may be a catch-all) with acts subsequently occurring which

[50] Evans, Incorporation by Reference, Integration, and Non-testamentary Acts, 25 Col. L. Rev. 879, 891 n. 60 (1925).

[51] Smith v. Smith, 113 Md. 495, 77 Atl. 975 (1910).

[52] Evans, op. cit. supra note 49. See Chaplin, Incorporation by Reference, 2 Col. L. Rev. 148 n. 2 (1902); Dobie, Testamentary Incorporation by Reference, 3 Va. L. Rev. 583 (1916); In re Keen, [1937] 1 Ch. 236; Riley v. McMaster, 313 Mass. 739, 49 N.E. 2d 240 (1943).

[53] Simon v. Grayson, 15 Cal. 2d 531, 102 P. 2d 1081 (1940), noted in 29 Calif. L. Rev. 94 (1941).

affect the substance of the gift. The late Professor Joseph Warren, in discussing the problem of the nontestamentary act, in a letter to the writer, posed this issue: A testator had made a will giving all his long-tailed horses to his son Robert and all those with bobbed tails to his son Samuel. Later on, becoming enraged at Robert, he bobbed the tails of all his long-tailed horses. Does Samuel profit thereby? The identical problem arises where a testator bequeaths all the contents of a chest or drawer to a beneficiary and later removes the contents, or a part, because of his displeasure toward the beneficiary. The subsequent act might be performed for the purpose of changing the will or it might have a wholly independent purpose. However, this seems to be only an illusory difficulty. The rule that a will speaks as of the date of death unless a contrary intent is manifest would probably govern such cases, and evidence would likely not be admitted to prove the true state of the testator's mind not appearing in the will.

In re Le Collen's Will[54] dealt with a bequest of certain envelopes, then in the testator's safe, which contained various securities. Of the six envelopes, four were identified by the addresses of persons whose names were mentioned in the will as legatees. These extraneous items were resorted to "for the purpose of identifying the thing intended to be given." The court observed that each case rests on its own facts—some extraneous papers are testamentary, while others are not, and they "run into each other by almost imperceptible gradations." Here the question could well be raised: How can they be used for identification unless they are nontestamentary? If, however, the will speaks only from death, they might be said to be included within the testamentary act. That, however, would not harmonize with the New York rule. Furthermore, this case seems to involve incorporation rather than the question of from what date the will speaks, and further illustrates the embarrassments which accrue from the application of the New York rule.

Somewhat parallel to the container cases is a recent Kentucky case.[55] The testator declared in this will: "I always expect to keep two automobiles. I want E. O. Magruder to have choice, Mrs. Charlotte Mills, the other." It was not known whether the testator owned any auto at the time the will was made, but at any rate he owned none when he died. Those he owned, if any, when he drew his will, were not identified specifically and a later act of acquisition of ownership would have been sufficient to pass two autos if he owned them at death. The identification could thus occur

[54] 72 N.Y.S. 2d 467 (Surr., 1947).

[55] Threlkeld v. Synodical Presbyterian Orphanage, 307 Ky. 234, 210 S.W. 2d 766 (1948).

by a later and probably a nontestamentary act. It is conceivable that he might purchase two autos for the express purpose of implementing the will. The will, however, would speak from his death.

Suppose that the testator in the Kentucky case had made a valid contract for the purchase of a Lincoln and of a Ford auto. Could it be urged that the later contract, made for independent reasons, had identified the two gifts? In fact, the testator had made an oral contract for two autos, which was not provable under the statute of frauds. Since the testator gave two autos only if he owned them, it appears to be the correct conclusion that the executor was under no obligation to complete the purchase at the behest of the legatees. The analysis, however, suggests that it is sufficient to apply the rule that the will speaks as of the date of death.

A different problem arises where the testator makes a specific gift which is later adeemed and is replaced by an article describable in the same terms as the one adeemed.[56]

VI. Secret Trusts

A perhaps similar problem arises where the testator seeks to create a trust for another, the beneficiary to be identified not by an act of independent significance, and often not by a writing, but by oral designation. It is the beneficiary, and not the property, who is relegated to this plight. There is no problem of integration of written and spoken language. The courts have, as Professors Bogert and Scott indicate,[57] either felt that they must let the devisee keep, or must enforce upon him a constructive trust, and have scarcely considered the possibilities of a resulting trust. An English writer divides the cases into a class of secret trusts and half-secret trusts, where in the latter case the trustee knows he is a trustee

[56] Moxon v. Crossley, [1927] 1 Ch. 364; Waldo v. Hayes, 96 App. Div. 454, 89 N.Y.S. 69 (1904); When a Will Speaks as to After-acquired Property, 23 Iowa L. Rev. 380 (1938). The more common issue which courts have to determine relates to the kind of contents which should pass. Thus, it is said that bonds are not included because they do not imply locality. Moore v. Moore, [1781] 28 E.R. 1030. The same has been held of savings bank pass books. Meegan v. Brennan, 63 R.I. 298, 7 A. 2d 663 (1939); Old Colony Trust Co. v. Hale, 302 Mass. 68, 18 N.E. 2d 432 (1939). But see Goff v. Cornwallis, 219 Mass. 226, 106 N.E. 860 (1914). Auto policies which have a surrender value and insurance policies have been treated similarly. It is often said that choses in action do not pass because they are evidence rather than property. Smith v. Smith, 113 Md. 495, 77 Atl. 975 (1910). Yet there is a tendency to the view that choses pass which consist of specialties such as savings bank pass books, bonds, and other securities which in common understanding have been regarded as property in themselves. This seems to be the better view. In re Robson, [1891] 2 Ch. 559; Buchwald v. Buchwald, 175 Md. 103, 199 Atl. 795 (1938); Appeal of Magoohan, 117 Pa. 238, 14 Atl. 816 (1887); Lock v. Noyes, 9 N.H. 430 (1838). Particular language and situations might even exclude money and other items. Creamer v. Harris, 90 Ohio 160, 106 N.E. 967 (1914); Meegan v. Brennan, 63 R.I. 298, 7 A. 2d 663 (1939). Whether given contents are to pass is a question of law. Dozier v. Bailey, 185 Ga. 666, 196 S.E. 420 (1938).

[57] 3 Bogert, Trusts and Trustees § 4995 (1935); 1 Scott, Trusts § 55.1 (1939).

because the will says so, but the benefit for a third person is not created by a proper writing. There are, as has often been said, three cases: 1) where the intended trustee does not even know he was expected to hold for another prior to the settlor's death; 2) where he has been only orally informed that he is a trustee, and the beneficiary is orally indicated; 3) where the will shows he is a trustee but does not identify the beneficiary. Neither Professor Bogert nor Professor Scott is satisfied with the conclusions reached by the courts of last resort in this situation.

It is apparent that there is no persuasive analogy between these secret and half-secret trusts on the one hand, and incorporation or nontestamentary act or a power of appointment on the other. It is believed that the Statute of Wills is not violated by these three latter devices. On the other hand, at least in form, the secret trust does violence to the statute. If the statute should be reworded so as to avoid this impingement, it would probably impair the significance attached to incorporation. Whether the statute should be so revised depends much upon the question whether the creation of secret trusts by the courts has on the whole functioned serviceably.

VII. Powers

In dealing with the organization and structure of wills, much attention has been given to various doctrines, such as incorporation by reference, integration, nontestamentary acts which affect the results to be reached by the will, and secret trusts where some violence is done to the statutory requirement of a writing, and to the question whether a will speaks as of the date of its execution or at the time of the death of the testator. Even here, the English courts and writers seem to avoid any consideration of nontestamentary acts.

Our own commentators also have scarcely observed that the exercise of a power may be a function quite similar to some of these concepts. This fact, so far as this writer knows, had not been adverted to in any adequate fashion until the publication of the Restatement on Property.[58]

A good illustration of such a function of a power appears in *McKallip's Estate*.[59] The testator there inserted into his will the following: "I leave Ida Crum Campbell authority to change my will according to her personal dictation—boat sailing." Ida's "dictation" after the testator's death changed the will in a manner entirely satisfactory to herself. The lower court felt that this was the same as allowing one person to make a will for another, but on appeal the provision was accurately interpreted as creat-

[58] 3 Rest., Property § 348 (1940).

[59] McKallip's Estate, 324 Pa. 438, 188 Atl. 343 (1936).

ing a general power. The use of powers for such purposes had long been known.[60] The will is later implemented, not by an incorporation, nor by an act with independent significance, nor by secret promises enforceable in equity, nor by construing it as of the date of the maker's death, but by an act of another whose only purpose is to complete the testator's scheme of distribution.

VIII. Conclusion

We conclude that although the statute requires a will to be in writing, there are many situations to which it cannot be applied. It is the business of courts to work the matter out as rationally as possible. As concerns incorporation, the matter of writing causes no difficulty unless the statute is interpreted so that the *whole* writing must be present when the will is executed. Future memoranda, though in writing, are not acceptable unless they assume a form similar to charges, which charges should not be at large but should be susceptible of proof of their correctness. Undelivered conveyances made prior to the will and referred to in it usually indicate the maker's intent that the grantee should have the property at the latter's death. It does not appear to be too great an evasion of principle to allow the incorporation of them and thus carry out an evident purpose shown in the will. A power of appointment is quite outside the provision of the statute which requires writing. The secret trust is on its face a violation of the statute, though it may now be recognized almost as well as is the power of appointment, to be outside the statute.

We have not been astute in following through those acts which add significance to a will but are performed independently of it. If such an act constitutes an already executed inter vivos trust, it could in most states be incorporated by reference. That, however, would not affect its independent significance. A settlement made later is also independent. So, too, the will of a second person may affect a prior testator's will, but be independent of it. Thus, no apology need be made in either case, nor need there be any hedging here because of the requirements of incorporation.

[60] 1 Simes, Future Interests § 245 (1936).

COLLECTION OF "FORFEITED" REAL ESTATE TAXES IN ILLINOIS*

WILLIAM H. SPECK†

ABOUT 250,000 parcels of Cook County real estate, almost one-fourth the total number in the county, are "forfeited" to the State each year for nonpayment of property taxes.[1] The Revenue Act of 1939 provides that tax delinquent properties not sold at the annual tax sales are "forfeited to the State of Illinois."[2] Tax buyers at the annual sales purchase properties in order to collect the taxes with heavy penalties from the delinquent owners, and select only those delinquent properties on which the prospects of early payment are good. The properties remaining unsold—those "forfeited"—are, therefore, mostly the unwanted residue which continue delinquent year after year and which have frequently been abandoned by their owners. The term "forfeited" carries a connotation of change in ownership which the actualities deny, for the State makes no claims to title or possession and the properties remain on the tax rolls. The term means only that the properties become liable to the collection methods which are the subject of this article.

The importance of these 250,000 parcels does not lie in the loss of tax revenue. In recent years only 3 or 4 per cent of the real estate levy has remained uncollected.[3] The importance lies in the removal from economic use of one-fourth the real estate parcels in the county. These parcels are chiefly lots in vacant subdivisions, dilapidated structures and lots in slum and blighted areas, and old and obsolete buildings elsewhere. The accumulated taxes constitute an obstacle to economic use. A prospective purchaser often finds that the delinquency amounts to more than the property is worth and that the settlement methods are too expensive and too dilatory. The owner clings to his title in the faint hope that he may some-

* This article is part of a larger study, Tax Sales and Tax Titles in Illinois, in preparation.

† Research Associate (Assistant Professor), University of Chicago Law School.

[1] Report of Edmund J. Brennan, Direct Department of Central Services, Cook County, Illinois, to the Board of Commissioners (March 4, 1949).

[2] Ill. Rev. Stat. (1947) c. 120, § 727 (Illinois Revenue Act of 1939, § 246). All section references without further designation are to the Illinois Revenue Act of 1939, Ill. Rev. Stat. (1947) c. 120, §§ 482 ff.

[3] Brennan, op. cit. supra note 1.

time be able to sell the property for more than the taxes. Meanwhile the properties become an economic desert.

The Illinois statutes afford four means of collecting or clearing off the delinquent taxes on forfeited properties. Two—the redemption of forfeitures and the civil action—permit no reduction of taxes legally due. The other two—the so-called "three-officer" plan and the forfeiture foreclosure—permit sale for what the properties will bring, regardless of whether all taxes legally due are paid. Unfortunately, no one of these is a collection method which a delinquent owner need fear or which affords a practical means of realizing the taxes from the property. The first merely affords an opportunity for the owner or a stranger to pay the taxes; the second has thus far proved unworkable; the last two permit owners to cancel taxes for a fraction of the amount due. By a curious twist, tax collection methods become tax cancellation methods. These collection methods will now be taken up in order.

a) Redemption and Purchase of Forfeited Properties

Section 272 of the Revenue Act of 1939 provides that "any person" may "redeem or purchase" forfeited properties. The inference that persons other than owners may purchase is made explicit by making property "purchased" expressly "subject to redemption, notice, etc., the same as if sold at regular public tax sale." This section thus essentially provides two methods of handling forfeitures, one of redemption by owners and perhaps other persons with an interest in the land and the other of purchase by strangers.

The procedure to redeem or purchase is fully outlined in the statute. The redeemer or purchaser applies to the county clerk, the clerk orders the county collector to receive the amount due, the collector accepts the amount due and gives a receipt in duplicate; one receipt is countersigned by the clerk and is retained by the redeemer or purchaser, and the other is filed by the clerk. The amount due is the sum of the "total amount of all taxes, statutory costs, interest prior to forfeiture, printers' fees due thereon" and forfeiture interest at varying rates for particular years, now 12 per cent per year or fraction.[4]

When special assessments are included in the forfeiture, the steps are slightly different. The amount of the specials must be paid to the municipal collector, or City Comptroller in Cook County, and the receipt filed with the clerk. The forfeiture interest on specials is 12 per cent the first

[4] Section 272 (a) makes provision for partial redemptions in counties other than Cook upon payment of the amounts due for one or more prior years beginning with the earliest year.

year and 6 per cent thereafter, with provision that interest over 7 per cent may be waived in Cook County.

When the forfeited property is purchased by a stranger, the purchase is expressly "subject to redemption, notice, etc., the same as if sold at regular public tax sale" and the receipt is "in the form of a certificate of purchase." The statute makes no mention of redemption penalties except as they may be included in the "etc." and are implicit in "certificate of purchase." However, the only case interpreting this section indicates that the purchaser is entitled to redemption penalties, for the court said: "From this it follows that the purchaser of the property at such sale acquires the same rights and stands in exactly the same position with respect to the property he would had he become a purchaser of the property at the prior public tax sale. . . ."[5] The court in this case granted mandamus to compel a collector to sell forfeited lands despite the collector's contention that this section was unconstitutional. It held that the rights of redemption specified in Section 5 of Article 9 of the Illinois Constitution were expressly preserved by the statute, that under Section 4 of that article once the property has been offered for sale but not sold at a regular public tax sale the legislature might provide means of subsequent disposition, and that the availability of foreclosure of the tax lien did not supersede purchase of forfeitures. Whether the legislature must still allow the two-year constitutional period of redemption in the disposition of forfeited properties when the owner has not redeemed for two or more years will not be decided as long as the statute itself allows redemption.

This section is, of course, used by owners to redeem, that is, pay up their taxes. It has also been used to some extent to purchase taxes. In Cook County for the years 1943–44, the treasurer's books show sales of forfeitures amounting to $276,955.38 with some of the large tax buyers being among the purchasers, but for 1945 they show only $27,934.82 sold. It is not altogether clear why tax buyers do not more often use this process rather than the tax sale to pick up properties to hold for redemption. Their rights, as the court stated above, would apparently be exactly the same as under purchase at a tax sale (except that taxes due would be increased by at least 12 per cent interest for a fraction of a year). They might find it more convenient to go over the forfeiture lists at their leisure instead of following the tax sales, and there would be no bidding even to threaten to reduce the amount of penalties. Some buyers say that after the sale all the properties likely to be redeemed have been taken, but the buyers control the tax sale market and could simply wait until after for-

[5] Ziccarelli v. Stuckart, 277 Ill. 26, 32, 115 N.E. 192, 194 (1917).

feiture to make their purchases. The more likely explanation is that a mass shift of tax buyers from the annual tax sale to the purchase of forfeitures would be such a brazen display of control over the market and would raise so many complaints from taxpayers who would thereby be subject to an extra 12 per cent interest that county collectors would refuse to cooperate.

As a means of collection, the purchase or redemption of forfeitures has no coercive force. The collector can do little but wait for owners or strangers to come forward. A stranger who purchases becomes a mere tax certificate and title holder, and has no means of compelling the owner to pay the taxes.

b) Civil Action for Taxes

Section 275 permits two types of actions for personal judgments for "taxes and special assessments on forfeited property." The first type is by "the county board" "in the name of the People of the State of Illinois" "for the whole amount due. . . ." The second is by "any county, city, town, school district or other municipal corporation to which any such tax or special assessment may be due . . . in its own name . . . for the amount . . . due any such corporation. . . ." The cases indicate that many local government bodies, apparently dissatisfied with the efforts of the county to collect their taxes, have attempted to bring their own actions with their own attorneys. Only the government bodies named, however, can bring these actions. Thus, the board of education[6] or the trustees of schools[7] cannot sue for the school district, and the People cannot sue for the use of any school district or the school trustees.[8] The Illinois Supreme Court has further reduced the scope of these actions by holding that a personal judgment for delinquent special assessments violates Section 9 of Article 9 of the Constitution.[9] Special taxation, the court reasoned, benefits owners only in proportion to the amount of their contiguous property and therefore can only be a charge on that property, not on the owner personally; further, special taxation is confined by the Constitution to "contiguous property," not to the owners thereof.

The prerequisites of suit are taxes due "on forfeited properties." This language might have been interpreted to require a technically valid assess-

[6] Board of Education v. Home Real Estate Improvement Corp., 378 Ill. 298, 38 N.E. 2d 17 (1941).

[7] School District No. 88 v. Kooper, 380 Ill. 68, 43 N.E. 2d 542 (1942).

[8] Ibid.

[9] City of East St. Louis v. Illinois State Trust Co., 372 Ill. 120, 22 N.E. 2d 944 (1939); Craw v. Village of Tolono, 96 Ill. 255 (1880).

ment, levy, and extension of the taxes together with a valid collection process to forfeiture. An early appellate court case seemed to go almost that far, saying that "to constitute a valid forfeiture, all of the steps provided by the statute must have been substantially complied with," naming particularly the notice, judgment, process of sale, offer of sale by a proper officer, and failure to sell for want of bidders.[10] But the Supreme Court in a case holding that the failure of the record to show advertisement of delinquent lands did not defeat the action, stated a much more lenient rule:

> It must be borne in mind the present suit was not instituted for the purpose of ascertaining whether the proceedings in the county court, culminating in the judgment against the lot charged with the taxes now sought to be recovered, strictly conforms to all the requirements of the statute, as in a case where the validity of a tax title is involved. On the contrary, this is simply a common law action of debt, to recover the town taxes due on the lot in question, for the years 1875, 1877, 1878, and 1879. In all cases where there has been a forfeiture of land for the taxes justly due upon it, this action will lie against the owner, notwithstanding omissions or irregularities have occurred in the tax proceedings which would be fatal to a tax title founded thereon. We have no doubt that one of the chief objects the legislature had in view in adopting this act, was to afford a safe and simple remedy for the collection of taxes, where, by reason of defects in the proceedings against the land itself, purchasers would be deterred from buying at tax sales. We hold, therefore, that it is sufficient to charge the owner, in any case of this character, where there has been a forfeiture, in fact, of delinquent land at a regular tax sale for the taxes legally due thereon.[11]

This leniency is probably the result of the fact that this action is like the contested litigation usually handled by courts, with personal service on the taxpayer and full opportunity to raise all defenses, and is not a summary, almost administrative proceeding to collect taxes with only published notice.

The lenient rule on prerequisites for suit is offset by permitting the taxpayer to raise any objections he may have to the tax. The statute provides:

> . . . the fact that real estate or personal property is assessed to a person, firm or corporation, shall be prima facie evidence that such person, firm or corporation was the owner thereof, and liable for the taxes for the year or years for which the assessment was made, and such fact may be proved by the introduction in evidence of the proper assessment book or roll, or other competent proof.

The People make a prima facie case by offering the tax judgment, sale, redemption, and forfeiture record and proving that the defendants were

[10] Smith v. People, 3 Ill. App. 380, 384 (1879).

[11] Sanderson v. Town of LaSalle, 117 Ill. 171, 174, 7 N.E. 114, 115 (1886); cf. People for the use of Christian County v. Davis, 112 Ill. 272, 282 (1884); see Greenwood v. Town of LaSalle, 137 Ill. 225, 26 N.E. 1089 (1891); Carrington v. People, 195 Ill. 484, 63 N.E. 163 (1902).

owners.[12] The suit must be brought against the person assessed for the property.[13] The case thus made, however, is only prima facie, and the court has said: "Such actions are subject to all such defenses as are allowable and proper in an application by the collector for judgment for delinquent taxes in the county court."[14] The court went on to name specifically the defenses of lack of authority to tax, assessment of property not subject to taxation, and fraudulent over-assessment of property. The court has denied judgments where the property was tax exempt[15] and where the tax was invalid.[16] This language does not, however, mean that after appearing and contesting the tax in the county court on the application for tax judgment, a taxpayer may contest the tax again in the civil action.[17] The judgment preceding the forfeiture thus is given finality as a prerequisite for bringing the action of debt but no more finality as to the liability for the tax than it is given in collateral attacks upon tax titles. An unsatisfied judgment in the annual judgment and sale process or in any other method of collecting taxes does not bar this action, and vice versa.[18]

The statute describes the suit as "a civil action" brought "in any court of competent jurisdiction." Before the adoption of the Illinois Civil Practice Act in 1933 the action was in debt and was not based on a contract.[19] It may be brought in a justice of the peace court.[20] The suit is not in rem for taxes but is a personal, civil action upon a tax liability,[21] so that the

[12] Carrington v. People, 195 Ill. 484, 63 N.E. 163 (1902); Harding v. People, 202 Ill. 122, 66 N.E. 962 (1903).

[13] Com'rs of Big Lake Special Drainage District v. Com'rs of Highways of Sand Ridge, 199 Ill. 132, 64 N.E. 1094 (1902); Coombs v. People, 198 Ill. 586, 64 N.E. 1056 (1902); Carrington v. People, 195 Ill. 484, 63 N.E. 163 (1902); Biggins v. People, 96 Ill. 381 (1880). The language in some of the cases is not clear as to whether the owner at the time of the assessment or at the time of the levy or the lien is liable, e.g., Bowman v. People, 114 Ill. 474, 477, 2 N.E. 484, 485 (1885) where the court said the defendant must be "such owner at the date such taxes become a charge against the real estate."

[14] Com'rs of Big Lake Special Drainage District v. Com'rs of Highways of Sand Ridge, 199 Ill. 132, 134, 64 N.E. 1094, 1094 (1902); see Neal Institute Co. v. Stuckart, 281 Ill. 526, 117 N.E. 1012 (1917).

[15] Elmwood Cemetery Co. v. People, 204 Ill. 468, 68 N.E. 500 (1903).

[16] Ohio & M. R. Co. v. Com'rs of Highways, 117 Ill. 279, 7 N.E. 663 (1886); cf. Belleville Nail Co. v. People, 98 Ill. 399 (1881).

[17] Harding v. People, 202 Ill. 122, 66 N.E. 962 (1903).

[18] People for use of Christian County v. Davis, 112 Ill. 272 (1884); People v. Stahl, 101 Ill. 346 (1882); see People ex rel. Wernsing v. Winter, 116 Ill. 211, 5 N.E. 536 (1886); cf. Byrne v. Town of LaSalle, 123 Ill. 581, 14 N.E. 679 (1888).

[19] People v. The Old Second National Bank of Aurora, 347 Ill. 640, 180 N.E. 408 (1932); People v. Dummer, 274 Ill. 637, 113 N.E. 934 (1916).

[20] For example, People v. Stahl, 101 Ill. 346 (1882); Kepley v. Jansen, 107 Ill. 79 (1883).

[21] Douthett v. Kettle, 104 Ill. 356 (1882); Langlois v. People, 212 Ill. 75, 72 N.E. 28 (1904).

procedure is that of civil actions rather than that of actions for taxes. The sale on execution is made by the sheriff as in judgment sales instead of by the county collector as in tax sales,[22] and the tracts must be offered separately, en masse, and in every combination instead of in consecutive order.[23] The period allowed for redemption is the fifteen months prescribed for judgment sales and not the two years fixed in the Constitution for tax sales.[24] The judgment has only the priority of a civil judgment and not that of the lien for taxes, so that it is subject to homestead,[25] prior mortgages,[26] and probably dower,[27] at least when the judgment is for taxes upon other lands. The interest on the judgment is the legal rate and not the much heavier forfeiture interest on taxes.[28] The statute expressly allows any of the government bodies which may sue for taxes to become purchasers at the sale.[29]

The collecting officers have seldom resorted to the civil action to collect real property taxes. One officer in Cook County estimated that not more than one or two suits are brought each year. The principal reason offered for the lack of use is that expensive, individual actions must be brought against each taxpayer who usually is difficult to find and who can raise innumerable objections to the taxes. This method of collection is not adapted to large scale use, and the costs of suing would probably in many instances exceed the taxes collected. Further, even after judgment has been obtained, prior claims will in many instances preclude execution. Finally, most taxpayers do not realize they are personally liable for real estate taxes, and resort to this remedy on a large scale would be very unpopular.

An indication of the results probable from the use of civil actions to collect real property taxes is perhaps given by its results in collecting per-

[22] Langlois v. People, 212 Ill. 75, 72 N.E. 28 (1904).

[23] Douthett v. Kettle, 104 Ill. 356 (1882); cf. Clark v. Zaleski, 253 Ill. 63, 69, 97 N.E. 272, 275 (1912).

[24] Douthett v. Kettle, 104 Ill. 356 (1882).

[25] Douthett v. Winter, 108 Ill. 330 (1884).

[26] Kepley v. Jansen, 107 Ill. 79 (1883).

[27] The personal judgment for taxes may be collected in the same manner as an ordinary judgment. See Greenwood v. Town of LaSalle, 137 Ill. 225, 230, 26 N.E. 1089, 1090 (1891); Byrne v. Town of LaSalle, 123 Ill. 581, 584, 14 N.E. 679, 680 (1888). Ordinary judgments are subordinate to dower. See Sisk v. Smith, 6 Ill. 503, 508 (1844). Consult Herbert, The Liquidation of the Lien of Taxes on Real Estate in Illinois, 1 John Marshall L. Q. 26, 47 (1935).

[28] Greenwood v. Town of LaSalle, 137 Ill. 225, 26 N.E. 1089 (1891). But judgment may include penalties, interest, and costs prior to forfeiture. Carrington v. People, 195 Ill. 484, 63 N.E. 163 (1902).

[29] Douthett v. Kettle, 104 Ill. 356 (1882).

sonal property taxes. During the thirties civil actions for personal property taxes were disappointing: a large proportion of summonses (as high as 84 per cent in one period) returned not found; substantial reductions in the taxes by court order; a very small proportion of satisfied judgments (as low as 6 or 7 per cent).[30]

This action is probably now only of practical use against large, conspicuous taxpayers with assets easily subject to execution. But given an adequate clerical and legal staff, complete tax and title records, and a real desire to collect, civil actions might bring good results against taxpayers who neglect to pay taxes although owning other resources. That the costs and inconvenience of the individual actions might exceed the collections from the individual defendants would not necessarily make actions uneconomical, for the wholesome effect upon payments by other taxpayers or by the same defendant in later years might more than offset any initial loss.

c) The "Three-Officer" Plan

The two preceding methods necessitate payment of taxes in full. In the civil action for taxes the amount due can be reduced for illegal levies or assessments and only part of the judgment may be collectible, but the full amount of unpaid legal taxes remains a lien on the land. Often these taxes amount to such a large proportion of the value of the land that owners will not redeem and no buyer can afford to purchase and pay up the taxes. The first method by which land may be cleared of taxes legally due is the special sale or "three-officer" plan.[31] The key sentence of Section 246 provides that "whenever the county judge, county clerk and county treasurer shall certify that the taxes and special assessments not withdrawn from collection on forfeited lands equal or exceed the actual value of such lands, the officer directed by law to expose for sale lands for delinquent taxes shall . . . offer for sale to the highest bidder the tract or lands. . . ."

The three cases and the few Attorney General opinions on this section leave many unanswered questions. The statute mentions only "taxes and special assessments" as the sum against which the value of the land is to be measured so that interest, costs, and penalties probably cannot be included. It refers only to "forfeited lands" so that if there has been one forfeiture, all taxes due even though not forfeited may probably be in-

[30] Research Department, Illinois Legislative Council, Tax Delinquency in Illinois with Particular Reference to Cook County 66–67 (April 1939); Report of the Chicago City Council Committee on Consolidation, Reorganisation, and Taxation 2 (Oct. 17, 1939); ibid., at 4 (Feb. 7, 1940).

[31] Consult Woods, Three Officer Plan for Quick Liquidation of Tax Judgment Liens in Illinois, 7 John Marshall L. Q. 341 (1942).

cluded. The cases give no hint whether the courts will adopt the interpretation of "forfeiture in fact" as in the civil action for taxes or will require a technically valid forfeiture; but the fact that the sale here is made by the collector upon the certificate of the officers without further judicial approval of the taxes or further opportunity to raise objections may influence the courts to insist upon a technically valid forfeiture. No cases illuminate the phrase "the actual value of such lands," although one Attorney General opinion uses the phrase "the fair market value of the property" as the equivalent.[32] Mention of this method of collection in several cases may indicate court approval of its constitutionality,[33] but that issue has never been determined.

The first step in the procedure is to obtain the certificate of the three officers. An appellate court holds that a taxpayer cannot on proof that the taxes due on his property exceed its value compel them to make out a certificate, for this method is only one of several for collecting taxes which these officers may in their discretion pursue.[34] Then there must be given "ten days' notice of the time and place of sale together with a description of the tract or lands so to be offered." The statute says nothing of how the notice must be given. One Attorney General opinion determined that the notice should be mailed to the owners or persons assessed just as notice is mailed to these persons after judgment for taxes and at least five days before the sale.[35] Such notice would only prompt owners to pay up their taxes to avoid the sale and bring the owners to bid at the sale. But if the taxes exceed the value of the property, it is unlikely that the owners will pay up, and the doctrine that no person liable for taxes can buy at a tax sale (his purchase operates only as a payment of taxes) would probably preclude owners from buying at this sale.[36] A year earlier another Attorney General opinion determined that notice by publication was contemplated.[37] Such notice would attract outside bidders and seems more nearly in accord with the purpose of the section. Perhaps, to be safe, both the owners and outsiders should be given notice. The county collector sells the land to the highest bidder. In the event no bid is received, the property remains on the forfeiture books.[38] The buyer receives a "certificate of pur-

[32] Ops. Ill. Att'y Gen. (1925), at 259.

[33] Particularly see Ziccarelli v. Stuckart, 277 Ill. 26, 30, 115 N.E. 192, 194 (1917).

[34] People ex rel. Rossiter v. Wagemann, 293 Ill. App. 37, 12 N.E. 2d 40 (1937).

[35] Ops. Ill. Att'y Gen. (1925), at 259.

[36] See, for example, Peabody v. Burri, 255 Ill. 592, 99 N.E. 690 (1912); Hanna v. Palmer, 194 Ill. 41, 61 N.E. 1051 (1901).

[37] Ops. Ill. Att'y Gen. (1923–24), at 430.

[38] Ibid.

chase . . . as in other cases in this Act provided," which the Attorney General interprets to be the same as that in the ordinary tax judgment and sale process.[39] The collector distributes the proceeds pro rata to the taxing bodies and can subtract only the printer's fee as costs.[40]

The statute makes no mention of redemption. Attorney General opinions, however, decide and assume that the constitutional two-year redemption period for tax sales applies.[41] Since the property is sold to the highest bidder and not by bidding on redemption penalties, there are no penalty bids. Redemption is made upon payment of the amount for which the property was sold,[42] subsequent taxes paid by the purchaser, interest on subsequent taxes (in one opinion "legal interest"[43] and in another the 7 per cent specified in the Revenue Act[44]), and fees for registering title. Subsequent taxes must be paid,[45] notice of the expiration of the redemption period given,[46] and probably affidavits of notice filed as in purchases at annual tax sales. The statute makes no mention of the issuance of a tax deed. Since there are no redemption penalties and since the buyer must put up some substantial bid instead of merely the fractional part of the value represented by current taxes due, the only purpose in bidding would be to obtain the property itself. Attorney General opinions indicate that the form of the deed is the same as in the annual tax judgment and sale process[47] and that the same title is acquired as at the annual tax sale.[48]

Any procedure involving the compromise of taxes offers an opportunity for owners to clear up their tax liabilities at substantial savings, and the cases indicate that taxpayers have attempted to seize the opportunity afforded by the "three-officer" plan. The recent appellate court case holding that the three officers cannot be compelled to certify when taxes exceed value prevents large-scale resort to this procedure on taxpayer initiative. In an 1888 case after a judgment in debt had been obtained against him, the taxpayer secured the certificate of the three officers and had the property sold for less than the taxes due.[49] The court held that the sale did not discharge the liability for taxes on the previous judgment except to the extent the taxes were collected, but indicated that the result might have been different had the county initiated the three-officer proceeding. The court said: ". . . we see nothing in the statute from which it may be in-

[39] Ibid. (1925), at 259.
[40] Ibid. (1932), at 653.
[41] Ibid. (1925), at 259; ibid. (1917–18), at 1098.
[42] Ibid. (1917–18), at 1098; ibid. (1932), at 653.
[43] Ibid. (1917–18), at 1098.
[44] Ibid. (1929), at 15.
[45] Ibid. (1925), at 259.
[46] Ibid. (1943), at 242.
[47] Ibid. and (1925), at 259.
[48] Ibid. (1915), at 191.
[49] Byrne v. Town of LaSalle, 123 Ill. 581, 14 N.E. 679 (1888).

ferred that the legislature ever intended, by its enactment to aid any person in escaping the payment of his share of the public burden."

Despite the court's admonition, this method has been rarely used and then only to cancel taxes spectacularly. In Cook County the only use that observers recall occurred back in 1908.[50] Downstate in Williamson County this method was used in 1934 to wipe out much delinquency.[51] A building and loan association filed a petition accompanied by sixteen typewritten pages listing delinquent properties. The three county officers granted certificates upon the oaths of the owner and two others that the property was not worth the taxes. Over 5,000 properties were offered. But the returns were reported as less than one-half cent on the dollar: $10,000 was recovered out of $2,157,000 in forfeitures. This experiment thus merely resulted in the wholesale cancellation of taxes.

The fear that the section will be a means of avoiding payment of taxes, confirmed by the Williamson County experience, has probably been the principal reason for its lack of use. Other reasons have been a hesitancy on the part of the officers to find that taxes exceed value, the reluctance to deprive an owner of his property by an administrative sale, the inability to pass any better title than at the ordinary tax sale, the incompleteness and uncertainty of the statute, and the availability of a much better method of selling to the highest bidder in the forfeiture foreclosure.

d) Forfeiture Foreclosures

Since 1819 the revenue statutes have provided that real property taxes are a lien upon the land,[52] but for sixty years no method was available to enforce the lien. In 1880 the collecting officers of Madison County brought a bill in equity to foreclose a tax lien. In *People v. Biggins*[53] the Illinois Supreme Court concluded that equity had no jurisdiction of such a bill. It reasoned that the lien was neither equitable nor contractual but was created by statute, that statutory liens "are enforced in the manner prescribed by the law which gave them existence," and that the annual judgment and sale for delinquent taxes is an adequate and complete "manner prescribed by the law" for enforcement. Justice Scott, dissenting, pointed out that the statutory means of enforcement is not necessarily exclusive and that unless the lien can be enforced it is useless. The next session of the legislature in 1881 amended the law to provide that the "lien may be foreclosed in equity, in any court of competent jurisdiction in the name of the People of Illinois, whenever the taxes for two or more years . . . have

[50] Woods, op. cit. supra note 31, at 341.
[51] Research Department, op. cit. supra note 30, at 52.
[52] Ill. L. (1819), p. 313.
[53] 96 Ill. 481 (1880).

been forfeited to the state. . . ."[54] This language has been retained ever since and sets forth the most popular and indeed the only practical means of collecting or clearing up the taxes on heavily delinquent properties.

The principle of the *Biggins* case, that the foreclosure of tax liens can proceed only as prescribed by law, has continued to be the guiding rule of equitable tax foreclosures. Thus, in 1932 the authority of an equity court in aid of its jurisdiction to foreclose taxes to appoint a receiver to take charge of the property and apply the proceeds from operations to the payment of taxes was denied,[55] and that power had also to be supplied by statute.[56] The Attorney General has ruled that in the foreclosure of a tax lien no deficiency judgment can be entered against the owner.[57] And recently the Supreme Court held that a private individual cannot seek an equitable accounting for taxes.[58] This principle could not, however, be applied without qualification, for the statute does not completely describe the procedure. The court has allowed a supplemental confirmation of the tax deed not provided by statute. Moreover, it is often not clear whether the statutes applicable to revenue govern exclusively or whether those applicable to foreclosures apply, so that cautious attorneys must attempt to comply with both.

Briefly, the proceedings under Section 216 (formerly Section 253) are as follows: Whenever real property has been forfeited to the State for the nonpayment of taxes for two or more years, the county board may request the state's attorney to foreclose the lien of delinquent taxes in a court of equity. The court determines the amount of taxes due, orders payment of that amount, and upon nonpayment orders the sale of the property by the county collector to the highest bidder. The owner and other persons interested in the property then have the two year constitutional period in which to redeem from the sale upon the payment of the bid price plus interest. The purchaser must pay taxes on the property during this two year period, must give notice of the expiration of the period of redemption, and is then entitled to the tax deed. The proceedings will now be discussed in detail.[59]

The language of the statute is permissive: the "lien may be foreclosed . . . ." Nevertheless, an early appellate case translated these words into the strong language of duty:

[54] Ill. L. (1881), p. 130.

[55] People v. Straus, 266 Ill. App. 95 (1932).

[56] Ill. L. (1933), p. 874.

[57] Ops. Ill. Att'y Gen. (1938), at 169.

[58] People ex rel. Morse v. Chambliss, 399 Ill. 151, 77 N.E. 2d 191 (1948).

[59] See also Pollak, The Foreclosure of Tax Liens in Illinois, 18 Taxes 91 (1940); Daniels, Handbook for Illinois Tax Foreclosures (c. 1943); 7 Nichols, Illinois Civil Practice §§ 7479–7507 (Supp., 1948).

Under this provision of the statute the State's Attorney is the proper officer to file the bill to foreclose the tax lien under Sec. 253, and undoubtedly it is his duty to do so, when it shall be known to him that the taxes upon any tract of land in his county have not been paid and the land has been forfeited for such nonpayment for two or more years.[60]

This court may have been referring to the duty of the state's attorney to act upon the request of the county board, for it went on to say that if the state's attorney neglected his duty, the board might order him to act and even appoint another attorney. Regardless of this case, the foreclosure has been treated as an optional, discretionary remedy which the board need not apply automatically to every tract of forfeited land two years delinquent.

The statute prescribes that the foreclosure action be instituted "in the name of the People of the State of Illinois," and actions not instituted in the name of the People are dismissed. Thus, where actions to foreclose drainage district special assessments were brought in the name of the district instead of the People, the suits were dismissed.[61] No relator is necessary.[62] Section 56a of the Local Improvement Act now authorizes foreclosure of special assessments in the name of the municipality.

The powers and practices of the state's attorneys in relation to these suits are unclear and various. The state's attorney is the proper person to institute suit,[63] and usually he acts at the request of the county board. State's attorneys outside Cook County are now allowed a fee of 10 per cent of the foreclosure sales, and the State's Attorney of Cook County is allowed a similar fee of 2 per cent.[64] Yet in some instances private attorneys have conducted the cases in the lower courts, and in two opinions the Supreme Court rejected the contention that their appearance for the People was fatal error. In one the court said that the collection of revenue is so important that the bill will not be dismissed because the attorney bringing suit is not the state's attorney,[65] and in another it said that the appearance of another attorney did not affect the rights of the parties and had in any event been authorized by the Board of County Commissioners and ratified by the state's attorney and Attorney General.[66] Whether the

[60] Ward v. City of Alton, 23 Ill. App. 475, 478 (1887).

[61] Gauen v. Drainage District, 131 Ill. 446, 23 N.E. 633 (1890); Sennott v. Moredock and Ivy Landing Drainage District No. 1, 155 Ill. 96, 39 N.E. 567 (1895); cf. Ward v. City of Alton, 23 Ill. App. 475 (1887).

[62] People v. Weber, 164 Ill. 412, 45 N.E. 723 (1897); Ops. Ill. Att'y Gen. (1931), at 147.

[63] People v. Sandvoss, 320 Ill. App. 239, 50 N.E. 2d 770 (1943).

[64] Ill. Rev. Stat. (1947), c. 53, § 8.

[65] Mix v. People, 116 Ill. 265, 4 N.E. 783 (1886).

[66] People v. Straus, 355 Ill. 640, 189 N.E. 877 (1934).

state's attorneys must foreclose upon the request of the county board is uncertain. State's Attorney Courtney in Cook County once temporarily discontinued forfeiture foreclosures contrary to the wishes of the county board.[67] Whether state's attorneys may institute foreclosures without the consent of the county board is also uncertain. The language of the appellate court already quoted would indicate that it is the duty of the state's attorney to prosecute forfeiture foreclosures even without the consent of the county board. Some state's attorneys urge that they have the power and even the duty to foreclose special assessments with general taxes without the consent of the municipalities involved and that they may bring foreclosure actions without express authority from county boards.[68] This confusion and division of responsibility necessarily prevents effective collection and illustrates the need for constitutional revision of the structure of Illinois local government.

In practice the initiative for instituting tax foreclosures has come to lie neither with the county board nor with the state's attorney but with the owner or some other person who promises a bid large enough to make foreclosure worth while. Experience has proved that foreclosure without some assurance of an adequate bid only results in sales for nominal amounts, sometimes as low as $1.00 per lot, to speculators, encourages delinquency by offering owners the prospect of clearing off back taxes at a fraction of their face amount, and neither brings in revenue nor transfers the title to persons likely to put the land to economic use and keep taxes paid up. The example usually given of an unsuccessful tax foreclosure without assurance of bids is one during the thirties against lands in Park Ridge subject to $325,000 in taxes.[69] The first sale brought bids of only $15,000 to $16,000, which the court disapproved, and a second sale brought still lower bids of only $12,000, which the court approved despite objections of inadequacy. Counties have therefore resorted to various devices to make sure that foreclosures are not used to wipe out taxes at a few cents on the dollar. The most popular has been the refusal to initiate foreclosures unless some one will guarantee a satisfactory bid. An alternative is to have the county bid in all properties which do not sell for more than a minimum fair valuation.

In Cook County the steps by which a private person induces the county board to institute a tax foreclosure are outlined on a sheet of "Instructions

[67] Chicago Sun, p. 4, col. 2 (March 28, 1942); ibid. p. 12, col. 7 (March 29, 1942); ibid. p. 24, col. 5 (March 30, 1942).

[68] Daniels, Handbook of Illinois Tax Foreclosures 17, 19 (c. 1943).

[69] Research Department, op. cit. supra note 30, at 51; Chicago Sun, p. 14, col. 6 (April 14, 1942). In People v. Anderson, 380 Ill. 158, 43 N.E. 2d 997 (1942), the Village of Lansing vacated sales where the bids were only $1.00 per lot.

for Attorneys for Filing Tax Foreclosure Cases." He must fill out a printed "Information Sheet," submit a photograph of the premises, write a letter containing certain specified information and promising a minimum guaranteed bid and the payment of subsequent taxes, and furnish on the printed forms available several copies of complaints, summonses, and affidavits for instituting the action. Until recently the county board would foreclose only on delinquent taxes for 1940 and earlier years, and taxes for 1941 and subsequent years had to be paid in full. On April 21, 1949, however, the board resolved to foreclose taxes through 1946 on vacant property. The former limitation remains in effect for improved property. From the photograph of the property, the description of the premises, and the information on taxes and assessments, the Delinquent Tax Committee of the board determines whether foreclosure for the guaranteed bid is to the advantage of the county. If the board gives its approval, the file is transferred to the state's attorney. He checks the file and prosecutes the action. Approval by the court is usually a matter of course, since there is no opposition.

The statutory prerequisite for tax foreclosure is that "the taxes for two or more years, upon the same description of property, shall have been forfeited to the State." It is settled that this requirement means forfeiture for the nonpayment of the taxes for two or more years and not two or more forfeitures,[70] and that all taxes may be included in the foreclosure whether or not included in the forfeiture.[71] The statute further provides that the amount shown upon the collector's books "shall be prima facie evidence of the amount of taxes against the said real property." The serious problem raised by these provisions is the extent to which the right to institute foreclosure depends upon the validity of the forfeiture and thus upon the validity of the tax judgment, the sale, and the taxes themselves. If this requirement means that these steps must all be technically valid judged by the standards of collateral attack upon the ordinary tax title, the foreclosure offers no chance of a better title than does the annual tax sale, for errors which invalidate the latter would also invalidate the former. Perhaps the foreclosure process would offer less chance of passing good title because the foreclosure itself affords additional opportunities for error.

The courts have not, however, held that every error in the process leading to the forfeiture renders the forfeiture invalid and prevents the foreclosure. In 1934 the court described its approach as follows:

[70] People v. Weber, 164 Ill. 412, 45 N.E. 723 (1896).

[71] Mix v. People, 122 Ill. 641, 14 N.E. 209 (1887).

> In considering the record in this respect [detailed and technical attacks upon the forfeitures] it is necessary to bear in mind that it is the purpose of the statute to permit an adjustment, accounting and collection of back taxes, regardless of omissions or irregularities which might be of such character as to be fatal to a tax title and therefore such as might effectually prevent bidding at a tax sale. The complexity of our tax-assessing and tax-collecting laws is such as to cast many difficulties in the path to a valid tax title, and it was obviously the legislative intent in passing section 253 [now section 216] to provide a remedy which would prove beneficial both to the people and the tax-payer. In equity, with all parties in court, it is at once possible for the tax-payer to secure for himself all just credits and adjustments and for the people to correct and overcome all technical objections. . . . The section under consideration, being remedial, must be liberally construed to effectuate its purpose, and any other construction would not only fail that purpose but render it entirely nugatory.[72]

It had earlier based liberal treatment on the powers of a court of equity. In a foreclosure suit where some of the taxes were claimed to be illegal and thus to preclude foreclosure, the Supreme Court indicated that equity could take an account to determine what taxes were legally due and that the taxpayer could not set aside a forfeiture without paying what was due in equity and good conscience.[73] Therefore, the inclusion of any illegal taxes which voids an annual tax judgment, sale, and title does not void the forfeiture for purposes of a tax foreclosure.

This attitude of the court is implemented by using the various saving provisions that have proved of little help in protecting tax titles to better effect in protecting tax foreclosures. Thus, in 1930 the court relied on the fact that the judgment of the county court is conclusive except where the tax has been paid or the land is not liable for the tax.[74] It held that the insufficiency of the certificate of publication of the delinquent list could not be raised because the county court had found that due notice had been given, that the filing of the delinquent list with one "Mike Godfrey, Clerk" who was both county clerk and clerk of the county court was a satisfaction of the requirement that it be filed with the clerk of the county court, and that errors and omissions in the dates on the certificates of levy were informalities not affecting substantial justice. Earlier the court held that the confirmation of special assessment bonds could not be attacked collaterally and that objectors were estopped because as commissioners of the drainage district they had agreed to an order compromising certain differences with the bondholders.[75] Still earlier the court held that

[72] People v. Straus, 355 Ill. 640, 643, 189 N.E. 877, 879 (1934).

[73] Hammond v. People, 169 Ill. 545, 48 N.E. 573 (1897).

[74] People v. Miller, 339 Ill. 573, 171 N.E. 672 (1930); cf. People v. Conleur, 294 Ill. 139, 128 N.E. 339 (1920) on the treatment of imperfections.

[75] People v. Weber, 164 Ill. 412, 45 N.E. 723 (1896).

fraudulent overassessment and reassessment did not prevent foreclosure, that assessment in the wrong name was no defense for the owner, and that objections to taxes for various bonds should have been raised when the objectors appeared at the county court's confirmation of the bonds.[76] These cases merely follow the pattern set by the first case applying the tax foreclosure process which held that, even though the tax judgments for previous years were erroneous, the back taxes themselves and the penalties could be added to the current taxes and that the remedy for erroneous judgments was to appeal them.[77]

One case only, *People v. Henckler*,[78] disturbs the finality of the tax judgment and forfeiture in a foreclosure proceeding. There the bill to foreclose was dismissed because the clerk's certificate of the tax judgment contained a scrawl only and thus was not "attested by the clerk, under seal of the court. . . ." as required by statute. The court reasoned that the statute authorized foreclosure only when the taxes for two or more years had been forfeited to the state, that the tax collector had no authority to sell for taxes except in compliance with the law upon a certificate under seal of a judgment for taxes, that the clerk's scrawl was not the seal of the court, and that since there was no valid sale there was no valid forfeiture.

The conclusion seems to be that once there has been a valid forfeiture for the nonpayment of some valid taxes for at least two years the prerequisites for tax foreclosure have been satisfied. That several judgments and forfeitures are invalid is irrelevant provided one is good. Even with respect to the forfeiture relied upon, the fact that part of the taxes are invalid is irrelevant because the court of equity will inquire into the objections and foreclose only for taxes actually due. Moreover, the court has more effectively used the statutory finality of the tax judgment and the various saving provisions in tax foreclosures than in annual tax judgments and sales. Greater finality is given the previous tax collecting procedure in foreclosure than is given it in the civil action for personal judgment; for in the civil action the court has expressly stated that all objections may be raised which might have been raised on application for judgment, including fraudulent overassessment, whereas in the foreclosure the court has indicated no such liberal ground for objections and has expressly excluded fraudulent overassessment.[79] In both the civil action and the foreclosure one of the reasons for the finality is that the taxpayer is afforded another opportunity after personal notice to contest any illegal taxes so that tech-

[76] Mix v. People, 116 Ill. 265, 4 N.E. 783 (1886).

[77] Biggins v. People, 106 Ill. 270 (1883).

[78] 137 Ill. 580, 27 N.E. 602 (1891).

[79] Mix v. People, 116 Ill. 265, 4 N.E. 783 (1886).

nicalities are not necessary to protect him. It should be noted that these cases have arisen on objections to foreclosure for taxes and not later in collateral attack upon the title obtained from the sale so that a stricter rule could still be adopted in the latter situation. But all parties to the foreclosure would be bound by the decree and precluded from collateral attack.

All persons should be named as defendants whose interests are to be foreclosed. On the surface the statements of the Supreme Court on parties seem inconsistent. Thus, in *People v. Weber*,[80] the taxpayer testified that he was married and resided on the property with his wife and that there were two mortgages on the property. He insisted that the wife and mortgagees were necessary parties. The court said:

> The homestead is not exempt from the lien for taxes, and that lien is superior to all the others. The interest of the wife or the mortgagees could not, under any circumstances or by any proof, be made superior to the lien for taxes, and as that question could not be made the subject of litigation, we see no reason for making any person defendant except the owner in possession of the land who is liable for the taxes, any more than in any other form of proceeding for the collection of such taxes. Every person interested in the premises must, at his peril, see that the lien for taxes is discharged.

But ten years earlier the court had noted:

> It is said others have an interest in these lands and lots who should be made parties to the suit. If there are any such persons, they, not being made parties, will not be bound by the decree in this case, nor will their interest in the property be affected thereby. But that ought not, so far as we can see, prevent foreclosure as to the interest of the defendants.[81]

And fifteen years later the court struck down a bill to review a tax foreclosure proceeding on the ground that the petitioner, Emma Glos, who claimed a one-third interest by quit claim deed from her husband, could not have been affected by the foreclosure since she was not named a party:

> As Emma Glos was not a party or privy to the original foreclosure proceedings the alleged notice as to said supplemental proceedings could not in any way preclude her from questioning the finding either in said original or supplemental proceedings. . . . The foreclosure proceedings being invalid on their face so far as they attempted to affect the rights of Emma J. Glos, the decree in title is no cloud on her title and there is no occasion for equitable interference.[82]

The holdings in these cases are not inconsistent: In the *Weber* case the

[80] 164 Ill. 412, 416, 45 N.E. 723, 724 (1896).

[81] Mix v. People, 116 Ill. 265, 278, 4 N.E. 783, 788 (1886).

[82] Glos v. People, 259 Ill. 332, 341, 344, 102 N.E. 763, 766, 768 (1913); cf. People v. Evans, 262 Ill. 235, 104 N.E. 646 (1914).

court merely held that the absence of the wife and the mortgagees did not preclude foreclosure as to the owners, and in the others it held that the interests of persons who were not made parties were not affected. But the fact that the interests of persons not made parties are not cut off is a very good reason for making them parties despite the contrary statement in the *Weber* case. The rule here seems to be the same as that in mortgage foreclosures: a senior mortgagee foreclosing need not name as defendants junior lien holders, but the rights of redemption of such holders not made defendants are not foreclosed.[83] The issue of the effect of a tax foreclosure on interests not made defendants is not likely to arise often because prudent attorneys try to name as defendants all known interests. If all claimants are named defendants their interests can be cut off by foreclosing the superior tax lien and the proceedings can serve an auxiliary purpose of quieting title. One state's attorney recommends that the county, county clerk, county treasurer, and any municipality levying special assessments with its clerk, collector, and treasurer also be made defendants because the decree will contain directions to them.[84]

The printed bill of complaint furnished by the Cook County State's Attorney provides for naming as "Unknown Owners" the holders of notes and interest coupons secured by a deed of trust and the beneficiaries under a trust and the "unknown heirs and devisees of ——— deceased." The inclusion of beneficiaries as unknown owners is made possible by a decision that special assessment bond and voucher holders need not be made parties to a suit by a municipality to foreclose special assessments.[85] The Supreme Court noted "that very often the bondholders are so numerous that to require them to be made parties in every suit to foreclose the lien of special assessments would be to impose an unreasonable and oppressive burden on the municipality." It pointed out that the beneficiaries of a trust are not necessary parties to an action to foreclose their interest where they are adequately represented by others, here by the municipality. To the bondholders' contention that the municipality was adversely interested because foreclosure of the special assessments would leave its own lien for general taxes paramount, the court replied that the municipality would be presumed to do its duty and would desire to assure payment of bondholders to facilitiate the financing of local improvements in the future.

[83] Reeve, The Law of Mortgages and Foreclosures in Illinois §§ 478, 493 (1932); Jones, A Treatise on the Law of Mortgages of Real Property §§ 1780, 1781 (8th ed., 1928).

[84] Daniels, Handbook of Illinois Tax Foreclosures 18 (c. 1943).

[85] Village of Lansing v. Sundstrom, 379 Ill. 121, 39 N.E. 2d 987 (1942); People v. Sandvoss, 320 Ill. App. 239, 50 N.E. 2d 770 (1943).

The result of these cases on parties is that all persons interested in the property must be made parties if their interests are to be affected, except that the beneficiaries of a trust need not be made parties when their interest is represented by a party. Defendants should include all owners of the fee including contingent and reversionary interests, all tenants for life or years, the executors or administrators of an estate, the person last taxed or assessed, all lienholders, trustees, judgment creditors, persons in possession, the county and municipal officers mentioned, and all other persons denominated "Unknown Owners." Attorneys planning to complete a foreclosure by redemption (as discussed below), however, sometimes deliberately omit parties in order to discourage bidding by outsiders.

Service upon all parties is facilitated by a recent amendment providing that whenever the taxes for five or more years have been forfeited, notice may be given to owners and parties interested by publication.[86] The notice must be in the form and contain the information specified and must be published for three successive weeks in a newspaper in the county. Occupants must still be served by summons or publication as required by law for equitable foreclosures. This provision was adopted in 1943 to facilitate foreclosures by state's attorneys without the staffs necessary for title searches to find owners for personal service, but doubt as to its constitutionality has limited its use.

This 1943 amendment to Section 216 also provides in a separate paragraph: "An action to foreclose the lien for delinquent taxes under the provisions of this Act is hereby declared to be an action in rem."[87] If "this Act" refers to the whole of Section 216, this language might make it unnecessary to name as defendants the numerous parties just mentioned and might permit foreclosure of their interests by action in rem. More probably, "this Act" refers to the amending act of 1943 which added this sentence and which contained in the next paragraph the provisions for foreclosure by publication when taxes for five years had been forfeited. Thus, forfeiture foreclosures, although usually in personam, may be in rem when taxes for five years have been forfeited and when notice is given by publication.

The procedure is as in equity foreclosures except as modified by the special requirements of the tax statutes.[88] Hundreds of tracts can be joined in

[86] The Attorney General says that the owner need not be made a party defendant under this provision but for safety should be made a defendant where known. Ops. Ill. Att'y Gen. (1943), at 218.

[87] Ill. L. (1943), p. 1119.

[88] Clark v. Zaleski, 253 Ill. 63, 97 N.E. 272 (1911); Ops. Ill. Att'y Gen. (1931), at 147; see People v. Cant, 260 Ill. 497, 501, 103 N.E. 232, 233 (1913).

one foreclosure.[89] The judge decides the issues raised by the answer, if any, determines the correct amount of taxes, penalties, and interest due against each parcel, and orders payment of that sum within a "short day," and on nonpayment orders the sale of the property.[90] He usually requires advertisement of the sale for three successive weeks.[91] Since the law is not clear whether the sale is governed by the Revenue Act as in tax sales or by the decree as in equity foreclosures, one state's attorney recommends that the decree require the sale to be carried out according to the terms of the Revenue Act.[92]

The sale is by the county collector to the person offering to pay the most for the property regardless of whether the highest offer is more or less than the taxes due. If the bid is less than the accumulated taxes, as is almost always the case, probably no deficiency judgment can be rendered against the owner since the statute makes no provision for such judgment.[93] In almost every instance the property is bid off by the person making the guaranteed bid.

The power of the county to bid in the property at a tax foreclosure sale is in doubt. The Supreme Court has held in one case that "there was no error" in the county purchasing and that "in any event" this is "a question in which the plaintiffs in error are not interested."[94] Nonetheless, the Attorney General says that a purchase by the county would be ultra vires and distinguishes this case on the ground that only an owner was objecting.[95] Municipalities have been denied the power to purchase at annual tax sales in the absence of an enabling statute,[96] and the Scavenger Act expressly gives taxing bodies power to bid. If the county could bid, it could foreclose to acquire properties for public purposes, could foreclose properties even without guaranteed bids, and by its bidding prevent them from going for a song. Opponents of county bidding fear that it would put the county into the real estate business with properties so acquired. When

[89] For example, People v. Anderson, 380 Ill. 158, 43 N.E. 2d 997 (1942); Village of Downer's Grove v. Glos, 307 Ill. 293, 138 N.E. 594 (1923).

[90] Mix v. People, 116 Ill. 265, 4 N.E. 783 (1886).

[91] Daniels, Handbook for Illinois Tax Foreclosures 25 (c. 1943); Clark v. Zaleski, 253 Ill. 63, 68, 97 N.E. 272, 275 (1911) (four weeks' publication).

[92] Daniels, Handbook for Illinois Tax Foreclosures 24, 28 (c. 1943).

[93] Ops. Ill. Att'y Gen. (1938), at 169.

[94] People v. Straus, 355 Ill. 640, 189 N.E. 877 (1934); cf. Douthett v. Kettle, 104 Ill. 356, 360 (1882) (county authorized to purchase on sale on personal judgment for taxes).

[95] Ops. Ill. Att'y Gen. (1937), at 283.

[96] City of Champaign v. Harmon, 98 Ill. 491 (1881); see O'Connell v. Sanford, 256 Ill. 62, 99 N.E. 885 (1912).

it had purchased, moreover, the county would probably be obliged to account to the other taxing bodies for their proportional share of the bid and to pay taxes on the property until it was devoted to a tax exempt public purpose.[97]

The proceeds of the sale are distributed pro rata among the taxing bodies according to the proportion of their tax claims. The county can only deduct the costs of foreclosure. In one case the county attempted to deduct from a sale price of $3,553 costs of foreclosure amounting to $228.38 and costs and redemption fees on the tax sales of previous years amounting to $2,275.40, leaving a balance of only $1,049.22 to be distributed pro rata; but the court held that taxes, penalties, interest, and costs on tax sales of previous years are equal items and must share pro rata.[98]

The fact that the county receives a pro rata share of the proceeds for penalties has in Cook County been a focal point for criticism. The county has been accused of waiving all penalties and a portion of the principal of taxes due in accepting guaranteed bids on foreclosure and then receiving a pro rata share of the proceeds on the basis of its right to the penalties.[99] The county's reply has been that its taxing power is limited by the constitution to $0.75 per $100, that its share of the proceeds has been spent for the public welfare, and that if this revenue source be taken away another must replace it.[100] In this connection it should be noted that the county loses by foreclosing only on taxes through 1940 (now 1946 on vacant property) and insisting on the payment of taxes and penalties for 1941 and subsequent years in full. The bidder in fixing the amount he can bid at the foreclosure will deduct the subsequent taxes and penalties which he must pay in full from what he is willing to pay for the property, so that the larger the subsequent taxes and penalties the smaller the foreclosure bid. This decline in the bids as subsequent taxes and penalties increase is illustrated in the figures for 1942–48.[101] Smaller bids mean that a smaller part of the recovery (foreclosure bid plus taxes and penalties 1941 to date) is apportioned to the earlier years when the county's share for penalties is large and more to the later years when its share for penalties is less.

The sale clears the land of the lien for delinquent taxes.[102] The lien is not revived by redemption or by the failure to take out the tax deed.[103]

[97] Cf. Ops. Ill. Att'y Gen. (1944), at 194.

[98] People v. Anderson, 380 Ill. 158, 43 N.E. 2d 997 (1942); see Ops. Ill. Att'y Gen. (1942), at 285.

[99] Chicago Sun, p. 24, col. 5 (March 30, 1942).

[100] Chicago Sun, p. 24, col. 5 (March 30, 1942); ibid., p. 12, col. 7 (March 29, 1942).

[101] Brennan, op. cit. supra note 1. [102] Clark v. Zaleski, 253 Ill. 63, 97 N.E. 272 (1911).

[103] French v. Toman, 375 Ill. 389, 31 N.E. 2d 801 (1940).

The statute makes no provision for certificates of purchase at foreclosure sales so that it would seem that the certificate should be the same as that at the regular tax sale, that is made out by the clerk and countersigned by the collector. But on the basis of two cases reaching the Illinois Supreme Court where the certificates involved had been made out by the collector and attested by the clerk, the Attorney General has given the opinion that the provisions of the revenue act for tax sales do not apply and that the certificate should be made out by the collector and attested by the clerk.[104] Cautious attorneys try to satisfy both requirements by having the certificates signed by both officers.[105]

After the sale the proceeding comes back to the judge for confirmation of the sale where the most important issue usually is the adequacy of the bid. The courts have repeatedly applied the rule that "Mere inadequacy of price is no reason for upsetting a judicial sale unless there are other irregularities."[106] This rule has been applied even where the party attempting to set aside the confirmation introduced evidence tending to show that the bidder would have been willing to pay twice his bid.[107] But in *People v. Schwartz*[108] the Supreme Court pointed out that this rule applies where parties are seeking on appeal to set aside the confirmation of a sale and does not govern the chancellor himself on the issue of confirming the sale. The chancellor has broad discretion in approving or disapproving the sale and may consider the adequacy of the price in making his decision. In this case the bid was $1,500 for property assessed at $5,414 (the court does not mention an increase to $19,485 in 1943), with back taxes through 1940 of $4,040.99, a total delinquency including interest and penalties of $10,414.-63, and a gross monthly income of $200. The court emphasized the amount of the assessment and the fact that the bid could be repaid from gross income in less than eight months to justify the chancellor's disapproval of the bid as inadequate. It did not, apparently, consider the taxes and penalties for 1941–44, amounting to $2,650, but here these had apparently already been paid. Subsequently a bid of $3,000 was accepted.

The amount of the bids deemed acceptable is crucially important in determining how much the tax foreclosure process will be used. Approval

[104] Ops. Ill. Att'y Gen. (1943), at 244; see Clark v. Zaleski, 253 Ill. 63, 68, 97 N.E. 272, 275 (1911).

[105] Daniels, Handbook of Illinois Tax Foreclosures 28 (c. 1943).

[106] People v. Anderson, 380 Ill. 158, 162, 43 N.E. 2d 997, 1000 (1942); People v. Sandvoss, 320 Ill. App. 239, 50 N.E. 2d 770 (1943); People v. Home Real Estate Improvement Corp., 316 Ill. App. 437, 45 N.E. 2d 289 (1942).

[107] People v. Cutler, 323 Ill. App. 466, 56 N.E. 2d 50 (1944).

[108] 397 Ill. 279, 73 N.E. 2d 279 (1947).

of low bids encourages use of the forfeiture foreclosure process in clearing up back taxes and releases land for development but also deprives the taxing bodies of revenues and discourages the payment of taxes currently by the prospect of foreclosures at less than face value after delinquency. Requiring high bids may halt the use of the forfeiture foreclosure process altogether because the purchaser acquires a title subject to many of the infirmities of a tax title, must pay full taxes, penalties, and interest 1941 to date, and must wait out a two-year period of redemption. The Chicago Bar Association has recommended that forfeiture foreclosures be permitted on taxes through 1945, but the county believes that such a shift would apprise taxpayers that they need not pay taxes but may settle them by foreclosure after a few years delinquency. On April 21, 1949, the Board of Commissioners of Cook County relaxed its opposition by resolving to permit foreclosures of taxes through 1946 on vacant property. Actually it makes absolutely no difference how many recent years' taxes are required to be paid in full as long as these taxes and penalties do not exceed what purchasers are willing to pay for the property. The purchaser determines the total amount he is willing to pay and then divides that sum between the bid on taxes of 1940 and earlier and the payment in full of subsequent taxes: the larger the amount required to pay subsequent taxes, the smaller the amount he will bid. The requirement that taxes after 1940 be paid in full thus amounts merely to fixing a minimum amount, increasing year by year, that a purchaser must pay to foreclose. Since this minimum amount is now approaching the value of the poorer forfeited properties remaining, the use of forfeiture foreclosures is declining and, unless some revision is made, in a few years may cease altogether.

The figure of 40 to 50 per cent of the full assessed valuation has been suggested as a minimum bid.[109] The Special Committee on Delinquent Taxes of the Chicago Association of Commerce recommended a minimum bid of 40 per cent full value, estimated that other costs of acquisition would increase purchase costs to 60 or 70 per cent of full value, and would leave 30 to 40 per cent as an incentive to purchase and compensation for the delay of two or three years in obtaining title.[110] It is not clear whether these minimums are intended to apply to the bid only or to the bid plus subsequent taxes required to be paid in full; they should take into consideration the subsequent taxes. This discount of at least 50 per cent is the

[109] Rees, A Study of Real Estate Tax Delinquency in Chicago and Cook County 28 (Committee on Public Expenditures, Feb. 1938) (40 per cent); Daniels, Handbook of Illinois Tax Foreclosures 7 (c. 1943) (50 per cent).

[110] Special Committee on Tax Delinquency of the Chicago Ass'n of Commerce, Tax Delinquency in Chicago and Cook County Illinois 30 (Feb. 10, 1941).

collection loss suffered from being obliged to dispose at an involuntary public sale, to allow at least two years for redemption, and to offer only an uncertain title.

The statute expressly provides that the sale is with "the same notice to interested parties and right of redemption from said sale, as is now provided by law and in conformity with Section four (4) and five (5) of Article IX of the Constitution of this State." In *Clark v. Zaleski*[111] the Supreme Court decided that the right of redemption ran for two years as required by the Constitution and the Revenue Act and not for the fifteen months of the Chancery Act, that the notice required was that now contained in Section 263 of the Revenue Act, but that the affidavit of notice in Section 265 was not required. The court reasoned that the affidavit of notice is necessary in an annual tax sale to preserve matter not anywhere of record but is not necessary in a tax foreclosure because the court's confirmation puts compliance with the notice in the record. The technical requirements for the notice of expiration of redemption are the same as those in the annual tax sales.

Whether the period of redemption is subject to the extensions provided in the Revenue Act when subsequent taxes are not paid for two years, a deed is not taken out within one year, or one of the owners is a minor or insane and whether the Reconveyance Act applies to permit the owner to demand reconveyance when possession is not taken within one year or when taxes are not paid for seven successive years, is uncertain.[112] The reference to the Constitution might be taken to limit the redemption to the two years there provided, but the reference to the Revenue Act might bring in all the extensions. The cases indicate that the period of redemption is extended if the purchaser permits the property to be again sold for taxes before the last day of the second annual tax sale.[113] These cases suggest that the other extensions of redemption are applicable, but they leave open the question whether the Reconveyance Act applies.

Since there is no penalty bid, redemption is made upon payment of the interest rate prescribed by the statute, now 1 per cent per month for the first six months and 6 per cent per year thereafter. If the owner redeems his tax foreclosed property shortly after the sale, this interest would be insufficient to compensate the purchaser for his expenses in attending and bidding in the property at the sale. To compensate purchasers more ade-

[111] 253 Ill. 63, 97 N.E. 272 (1911). The court cannot regulate the right of redemption. People v. Thain, 392 Ill. 592, 65 N.E. 2d 344 (1946).

[112] §§ 253, 254.

[113] People v. Banks, 294 Ill. 464, 128 N.E. 576 (1920); People v. Thain, 392 Ill. 592, 65 N.E. 2d 344 (1946).

quately in the event of early redemptions, a bill in the 1947 legislature would have increased the interest to 10 per cent for the first six months or fraction thereof.[114] The mechanics of redemption—whether governed by the Judgments and Decrees Act or the Revenue Act—are also uncertain. One state's attorney recommends compliance with the former statute by endorsing a certificate of redemption on the certificate of purchase and recording the same, followed by compliance with the latter by surrendering the certificate to the county clerk and obtaining a certificate of redemption.[115]

Upon the expiration of the period of redemption and upon compliance with the requirements of notice the purchaser may petition the court to order the issuance of a tax deed. The jurisdiction of the court in which the foreclosure was conducted to approve the notice of the expiration of redemption and order the issuance of the deed was upheld in *Clark v. Zaleski*[116] and is the outstanding instance where the courts have not limited foreclosure proceedings to the precise steps outlined in the statute. Recourse to the court for confirmation is optional, for the purchaser may simply get the deed from the county clerk as in the case of ordinary tax deeds. Since, however, a petition to the court and approval of issuance is judicial confirmation of the validity of the notice of redemption and all prior steps and is binding upon all parties, confirmation greatly improves the purchaser's title. The court requires the same particularity in the allegations of the notice of expiration of redemption in the petition for confirmation that it requires in the affidavits submitted in the tax judgment and sale process.[117]

The title thus obtained by the process of forfeiture foreclosure is superior to that obtained by the tax judgment and sale process largely because of two circumstances: First, all persons interested in the property have been served and brought before the court in the forfeiture foreclosure, and after an opportunity to contest illegal taxes, their interests have been cut off by judicial sale. Second, the court has ordered the issuance of the tax deed and thus confirmed the legality of prior proceedings including the notice of the expiration of redemption, and its order is binding upon all parties unless reversed on appeal. The proceedings thus avoid the ex parte character which has probably been responsible for most of the uncertainties of title in the annual tax judgment and sale. Moreover, the sale is

[114] Ill. H. B. 712, 65th Gen. Assemb., Reg. Sess. (May 14, 1947).

[115] Daniels, Handbook of Illinois Tax Foreclosures 30 (c. 1943).

[116] 253 Ill. 63, 97 N.E. 272 (1911); see also Hammond v. People, 178 Ill. 503, 52 N.E. 1030 (1899).

[117] People v. Banks, 272 Ill. 502, 112 N.E. 269 (1916).

made to the highest bidder, so that the owner can less readily gain the sympathy of the courts on the ground that he is losing his property for a fraction of its value.

The Illinois Supreme Court by *Greenwald v. McCarthy*,[118] decided in 1949, has given substantial protection to titles based on forfeiture foreclosures. Here the plaintiff sought to set aside the tax deed obtained on foreclosure in 1941 on the grounds that the affidavit of nonresidence erroneously stated her residence was unknown despite the fact that the 1932 tax records and certain special assessment records showed her then New York address, that the sale price was grossly inadequate, that the published notice of expiration of redemption gave the wrong date, that the purchaser at the tax sale and his assignee were in collusion with the attorney causing the foreclosure action to be filed and were therefore chargeable with notice of defects in the proceedings, and that the foreclosure deprived her of property without due process of law. The Supreme Court affirmed the dismissal of the complaint on the ground that the court had jurisdiction of the plaintiff in the tax foreclosure action so that collateral attack on the title failed. It pointed out that the plaintiff did not allege that her 1941 New York address was available or that notice to the other addresses would have reached her. It held that, so far as the record showed, the present owners were innocent third parties whose titles could not be attacked by proof of a false affidavit. It also held that the confirmation of the issuance of the deed by the court precluded collateral attack on the ground that the date of expiration of redemption was erroneously stated. This decision is in striking contrast with the technical strictness with which the court has treated titles acquired through annual tax sales, and should improve the marketability of tax titles.

Nevertheless, the forfeiture foreclosure has not afforded a desirable means for buyers to pick up real estate. The title is still somewhat uncertain, the proceedings are expensive, and the purchaser must wait at least two years and perhaps more for the period of redemption to expire. The *McCarthy* case increases the security of the titles but does nothing about the two year delay for redemption.

The result is that most tax foreclosures are carried out in cooperation with the owner of the right of redemption. The tax purchaser is usually a dummy, and the person for whose benefit the sale is being conducted redeems from the dummy. This person, who may be either the original owner or his grantee, then has a good title clear of the taxes. Finally, he sues to enjoin the collector from collecting that portion of the delinquent taxes

[118] 402 Ill. 135, 83 N.E. 2d 491 (1949).

that was not satisfied by the sale.[119] This type of foreclosure is usually denominated a "voluntary forfeiture foreclosure" to indicate that it is carried out in cooperation with the owner, as contrasted with an "involuntary forfeiture foreclosure" (perhaps more accurately described as an "adverse foreclosure") carried out on behalf of a stranger. Although there are no statistics on the respective use of the voluntary as compared with the involuntary method, observers estimate that in Cook County 90 per cent of the foreclosures have been voluntary.

The legality of voluntary foreclosures was upheld in *French v. Toman*.[120] Lola M. French had obtained title to a piece of property on which the taxes of 1927 to 1937 were delinquent. Her title was acquired after the 1937 taxes became a lien. A forfeiture foreclosure decree found $7,466.47 due, and the collector sold for $2,200 to one Snyder who assigned to Murphy. Lola French redeemed from Murphy and brought this suit to enjoin collection of the balance of taxes due. The court held that the phrase the taxes remain a lien "until the same are paid" referred not exclusively to full payment but also to payment of the amount of the foreclosure sale, that the sale extinguished the tax claim, and that the redemption did not revive the tax lien. On the latter point the court used the analogy of a junior encumbrancer who on redemption takes free of any lien for unpaid portions of the debt not realized at the sale, and emphasized that the statute did not provide for reviving the extinguished lien. However, it carefully left open two situations: First, it pointed out that here there was no claim of collusion between the owner and the tax purchaser. Second, it said:

> The argument that to allow a taxpayer to default and later redeem for a smaller amount is unfair to the State and other taxpayers does not apply to this case. Appellee was not the taxpayer when the taxes were assessed. The significant fact is that the legislature has not provided that the tax lien be revived where one who owns the property when the taxes were assessed conveys to another, and the grantee redeems from a tax foreclosure sale.

The first exception for collusion between the owner and the purchaser would cover most tax sales conducted in this manner, for in almost every instance the tax purchaser is a dummy for the owner or for a prospective grantee of the owner. The second exception where the redeemer was the owner at the time the taxes fell due can usually be avoided because the occasion for the elimination of delinquent taxes usually is a transfer of the ownership. The new owner would not be liable for the taxes, and an ar-

[119] The Chicago Title & Trust Co. requires an injunction whenever the taxes and penalties not satisfied by the foreclosure sale bid exceed $7500.

[120] 375 Ill. 389, 396, 31 N.E. 2d 801, 804 (1940).

rangement can usually be made so that the new owner redeems. A 1943 amendment that taxes are a lien only "until the real property is sold pursuant to any provisions of this Act" may have cured both exceptions.

The result of the use of redemption is that the forfeiture foreclosure ceases to be a means of collecting taxes and becomes a means of totally extinguishing tax liens for a fraction of their face amount. What the method can accomplish in extinguishing tax claims while leaving the owner most of the value is illustrated by the situation revealed in *People ex rel. Schreiner v. Courtney*.[121] In 1937 Mildred F. Lindop acquired title to a tract of land as trustee for John C. Lindop. The property was assessed at $13,974, and the taxes were delinquent from 1931. In 1939 she contracted to sell the property to the Chicago Rivet & Machine Co. for $30,000, subject to 1940 taxes. Instead of paying the delinquent taxes with interest, a total of $16,245.09, the parties instituted a tax foreclosure suit, the property was sold to George Ott for $5,500, the amount of the guaranteed bid, and the rivet company redeemed from the sale and enjoined collection of the deficiency. In a taxpayer's suit against the former owners, the present owners, the purchaser, the state's attorney and his assistants and bondsmen, and the Board of County Commissioners, to declare the property still liable for the deficiency or to hold the defendants personally liable, the court denied relief. Another illustration is the county board's recent approval of a guaranteed bid of $277,698 on $1,300,000 back taxes of the Auditorium Hotel Building after Roosevelt College had paid the owners $500,000 for the building.[122] The college probably regarded the building as worth approximately $777,000, the sum of the amount it paid for the building and for the back tax settlement. Even though the back taxes, a prior lien, were almost twice this sum, ineffective tax collection methods enabled the owners whose interest was subordinate to the taxes to retain two-thirds the proceeds.

At its best, voluntary foreclosure is a sale by the owner of his period of redemption and ability to convey good title, that is, of his willingness to cooperate by redeeming and conveying the property. Without his cooperation the person interested in purchasing at the foreclosure sale would have to wait out the period of redemption and take his chances on the title. He is willing to pay substantial sums to avoid the inefficiency of the foreclosure process. The proposals for minimum guaranteed bids of 40 to 50 per cent of assessed value indicate that the owner's cooperation is worth

[121] 380 Ill. 171, 43 N.E. 2d 982 (1942).

[122] Chicago Sun-Times, p. 27, col. 1 (June 29, 1948); cf. Chicago Sun, p. 12, col. 5 (March 2, 1942).

about half the value of the property. But at their worst, voluntary foreclosures have enabled owners to retain much more than even liberal payment for their redemption. The bids actually accepted in the few cases that have reached the courts, the figures on percentages of taxes recovered,[123] together with the fact that critics find it necessary to suggest minimum bids of 40 to 50 per cent, all indicate that often much less than half is realized from properties foreclosed. The lack of vigilance of the collector, the Board of County Commissioners, and the state's attorney in many instances has enabled owners to avoid payment of taxes and to obtain sums for their ownership which according to priority belong to the taxing bodies.

The problems of the foreclosure of special assessments require separate discussion. The liens of special assessments and general taxes are on a parity,[124] and the two may be foreclosed together in the same suit.[125] Section 56 of the Local Improvement Act also authorizes the municipalities to sell the assessment lien, and either the municipality or its assignee may bring an action to foreclose the lien in its own name without any forfeiture as a prerequisite.[126] The chief importance of special assessments lies in their effect upon the foreclosure process. If there are delinquent special assessments in addition to delinquent general taxes, the purchaser at a foreclosure sale will take the former into account by reducing the amount he will bid for the property. Further, once the delinquent general taxes have been cleared away by foreclosure, the specials remain unchallenged as a prior lien. Where the taxes have been paid off for only a fraction of their face amount, the specials now stand a good chance of being paid in full.[127] In order to prevent the presence of special assessments from depressing or eliminating altogether the bidding and to prevent special as-

[123] There is no information on the relation of foreclosure bids to assessed values, but the relation of bids to principal of delinquent taxes (not including penalties) has ranged on improved properties from an average of 67 per cent in 1942 to 31 per cent in 1948 and on vacant properties from 50 per cent to 23 per cent. See Brennan, op. cit. supra note 1. Assuming the high tax rate of 4 per cent, taxes would have to be delinquent for 25 years before delinquent taxes equaled assessed values. More likely, most properties were delinquent only half that long or less (1928–40) so that percentages of recoveries to assessed value would be only half as large as the percentages of recoveries to principal taxes, that is 33 to 25 per cent and 25 to 12 per cent. The higher percentage in each instance is probably more nearly correct, for in the later years to which the lower percentages relate purchasers had in addition to spend large sums to pay taxes after 1940 in full.

[124] People v. Taylorville Sanitary District, 371 Ill. 280, 20 N.E. 2d 576 (1939).

[125] People v. Sandvoss, 320 Ill. App. 239, 50 N.E. 2d 770 (1943).

[126] Ill. Rev. Stat. (1947), c. 24, § 84—56.

[127] Cf. Village of Westchester v. Holmes, 390 Ill. 436, 62 N.E. 2d 410 (1945) (special assessment bondholders not entitled of right to a refunding which would extend their lien in full after foreclosure of general taxes for a fraction).

sessment bondholders from obtaining more favorable treatment than the taxing bodies, specials and generals should be foreclosed together. Some attorneys foreclose specials first, while general taxes are still liens to discourage bidding by outsiders, and then foreclose the general taxes. In either case attorneys instituting foreclosure proceedings must persuade the municipal authorities to permit the foreclosure of specials or to join the foreclosure of general taxes. Municipalities formerly were reluctant to foreclose special assessments for fear they would be liable to the bondholders should the sale, as is likely, fail to yield enough to pay claims in full.[128] Now, most municipalities will permit foreclosure of specials, and a few have a definite policy of permitting foreclosure for 40 per cent of the specials on vacant land and 60 per cent on improved land. Some state's attorneys contend that special assessments must be foreclosed when general taxes are foreclosed in order to assure equal treatment of the two liens and have suggested that state's attorneys have power to include special assessments in foreclosures without the consent of the municipalities.[129] On April 21, 1949, the Board of Commissioners of Cook County resolved to include special assessments in foreclosure settlements, but the procedure has not yet been determined.

In Chicago the procedure to obtain City Council approval to foreclose special assessments is set forth in a resolution and is similar to that prescribed to induce the county to foreclose general taxes.[130] Since a program of foreclosing on delinquent special assessments was instituted in 1946, about 200 cases involving 3,500 lots have been submitted to the council and settlements have been made on 1,200 lots for two and a quarter million dollars of assessments.[131]

The administrative use to which Cook County has put the forfeiture foreclosure has already been discussed in connection with the process itself, but the results obtained remain to be given. Up to the end of 1948, 9,707 petitions to foreclose had been approved by the county board, 117,966 parcels of property had been foreclosed, and $31,595,808.28 of guaranteed bids had been accepted on delinquent taxes of 1878–1940 totaling $67,610,222.05.[132] The total of taxes does not include penalties, which might have almost doubled the total due. In addition, taxes for

[128] Report of the Taxation Committee, City Club of Chicago, Real Estate Tax Delinquency and Tax Foreclosure Suits 6 (1941); Chicago Sun, p. 34, col. 6 (April 5, 1942).

[129] Daniels, Handbook of Illinois Tax Foreclosures 17, 19 (c. 1943).

[130] Resolution adopted by the Chicago City Council April 16, 1945.

[131] Chicago Tribune, p. 8, col. 1 (July 7, 1948).

[132] Brennan, op. cit. supra note 1.

1941–46 amounting to about $40,000,000 were paid in full.[133] The guaranteed bids on vacant properties ranged from an average of 50 per cent of the principal tax indebtedness in 1942 to 23.2 per cent in 1948 and on improved properties from 67 per cent in 1942 to 31 per cent in 1948.[134] The decline in percentage of taxes recovered is attributed to the lesser desirability of the properties remaining as each year passes and the higher amount that the purchaser must allow to pay taxes 1941 to date in full.

A variation in the Cook County use was the activity of the West Central Association in the thirties in searching out foreclosure purchasers.[135] The association selected a number of abandoned properties near the central business district, made a preliminary tax and title search, and filed a foreclosure suit. It then sought purchasers to make guaranteed bids and advance the cost of a full title search. When such a purchaser was found, a full title opinion was obtained, the complaint was amended, the sale was completed, and the purchaser obtained title after two years.

Downstate, Cumberland County in 1936 undertook an interesting and successful program of foreclosing delinquent properties.[136] The county contracted with an attorney to carry out the foreclosures at a fee equal to the 1936 taxes. A preliminary written notice to all interested parties that foreclosure would be undertaken brought payments of taxes on two-thirds of the properties. One hundred three individual tax foreclosures were instituted against the remaining tracts. Two were never prosecuted further because interested parties could not be located. Thirty were redeemed before the court had taken action at a time when average costs (filing fees, summonses, and first notices, not including the attorney's fee) were $11.76. Thirteen more were redeemed before actual sale when average costs were $31.47. At the sale the county made a protective bid based upon an appraisal by its finance committee. Seven more tracts were redeemed during the two year redemption period when costs averaged $40.55. Of the 51 tracts eligible for deed, 23 certificates were held privately and 28 were held by the county. Up to July 1939, 23 deeds had been issued, 7 to individuals and 16 to the county, with average costs of $48.88. All except one tract were sold for as much or more than taxes and costs. The costs to obtain a deed would have exceeded the amount received at the sale in one-third the cases, but in fact on only 4 of the 23 properties conveyed did

[133] J. of Proceedings of the Board of County Com'rs of Cook County 949 (March 19, 1948).

[134] Brennan, op. cit. supra note 1.

[135] Report of the Taxation Committee, City Club of Chicago, op. cit. supra note 128, at 5–6.

[136] Walter, Use of the Illinois Tax Foreclosure Procedure for Collection of Delinquent Taxes (Bureau of Agricultural Economics, hectographed, Feb. 1940).

costs exceed the amount received at the sale. Most of the costs (50–75 per cent) were for publishing legal notices, and the remaining costs in filing and other fees ($12.00 per case) were paid back to the county through the recorder's office. On the 101 properties with taxes due of $14,477.80, $7,765.05 were collected. The county in addition bid in for $3,197.69 twenty-eight properties with taxes of $4,850.15 and costs of $1,369.65. Recoveries from the sale of the properties purchased by the county were not expected to exceed $3,300. In addition to these costs, the attorney by contract was paid over $2,000. The results of this foreclosure program, though costly, were regarded as very satisfactory, both because the recoveries of delinquent taxes were substantial and because 90 per cent of the delinquent properties passed into the hands of persons likely to pay subsequent taxes.

State's Attorney Lee E. Daniels of DuPage County, faced with 66,000 delinquent lots, one-fourth the real estate in the county, has used the foreclosure process to clear off delinquencies on 30,000 lots.[137] Foreclosures were begun against all properties on which someone would bid 50 per cent of the actual value and in some instances against others without a guaranteed bid.[138] The staff expenses of foreclosure were paid from the 10 per cent of bids which State's Attorneys outside Cook County are allowed as a fee.

Several recommendations for improving the forfeiture foreclosure process have already been mentioned. These have included the clarification of the county's power to bid in properties and to hold them without obligation to pay taxes, the foreclosure of special assessments with general taxes, and a higher interest rate applicable to redemptions. Most of the criticisms and recommendations, however, have centered around the problem of fixing standard minimum bids to the end that all taxpayers will be treated alike and that no taxpayer will be allowed to settle for too small a part of the value of his property. Some suggested minimum bids would be based on a percentage of the taxes and penalties, in one suggestion 110 per cent of the taxes and in another 88 per cent of the taxes and penalties.[139] Others would be based on a percentage of the value of the property, usually 40 to 50 per cent of the full assessed value.[140] On another tack it has been urged that settlements take account of the financial circumstances of the taxpayer.[141] The Taxation Committee of the City Club in 1941 recommended

[137] Chicago Tribune, p. 8, col. 1 (July 8, 1948).

[138] Daniels, Handbook for Illinois Tax Foreclosures 7 (c. 1943).

[139] Chicago Sun, p. 28, col. 4 (April 6, 1942).

[140] See note 109 supra.

[141] Chicago Sun, p. 28, col. 2 (April 2, 1942); ibid., p. 10, col. 2 (April 8, 1942).

that voluntary foreclosures be made available to all taxpayers willing to pay the principal of taxes prior to 1938 with 6 per cent interest plus subsequent taxes and penalties in full or 55 per cent of the full assessed valuation, whichever was lower, and that involuntary foreclosures for 10 per cent more with the county bidding be brought against taxpayers failing to take advantage of the voluntary plan.[142] Some attorneys have suggested that foreclosures be farmed out to private attorneys as was done in Cumberland County.[143]

Two recent sets of proposals contain the current recommendations for change in forfeiture foreclosures. House Bill 712 in the 65th General Assembly would have increased the redemption interest to 10 per cent for the first six months, required that tax districts with special assessments be named defendants, expressly permitted the foreclosure notices to list more than one lot or tract, eliminated the requirement that sales be conducted under the supervision of the court, and added a provision to foreclose properties with taxes forfeited for five years on deposit of 25 per cent of the current assessed valuation or the total of the tax liens, whichever was less. The Chicago Bar Association in 1948 recommended that the state's attorney include delinquent taxes down to 1945 in the foreclosure, that the county board authorize the state's attorney to foreclose when a bid of 40 per cent of the current assessed value is received, that the certificate of the county clerk as to the amount of unpaid taxes on a parcel be accepted in lieu of proof, that the state's attorney make use of the in rem foreclosure for taxes forfeited for five years, testing its constitutionality if necessary, and that the City of Chicago be named defendant and be required to counterclaim for foreclosure on all parcels with delinquent special assessments. The association in April 1949 modified these recommendations by proposing that foreclosure actions for special assessments and general taxes be consolidated and that bids be accepted for all delinquent taxes to date on a graduated scale ranging from 40 per cent of all taxes, special assessments, interest, and penalties due on lots assessed at $3,000 to $10,000 down to 25 per cent on lots assessed at less than $1,000. The substitution of the total of taxes, etc., for the current assessed valuation as the base against which bids are to be measured seems unfortunate, for this total bears no necessary relation, as the current assessed valuation should, to the market value of the property which the county should be able to realize on sale.

The Illinois Revenue Laws Commission has just recommended provision for a fifth method of handling forfeitures, namely "that the State's

[142] Taxation Committee, City Club of Chicago, op. cit. supra note 118, at 8.

[143] Chicago Sun, p. 30, col. 5 (April 3, 1942).

Attorney be permitted to file a suit in equity to terminate the right of taxpayers to redeem from forfeitures where a parcel of real estate has been forfeited for non-payment of taxes of ten or more years and to vest clear title in the State."[144] The county boards would then sell the properties and distribute the proceeds. Senate Bill 344 contains this proposal. If adopted, this procedure might prove to be inexpensive and expeditious and might supersede the Scavenger Act as a means of collecting on properties ten years delinquent. However, the title of the State may prove unmarketable, for the courts have inclined toward strict construction of tax sale measures that do not give owners personal notice and an opportunity to raise objections.

This article has discussed the four methods available to collect taxes upon the over 250,000 pieces of property that continue year after year to be forfeited to the State for nonpayment of taxes. The variety of methods is illusory, for none has proved successful in collecting taxes. The redemption of purchase of forfeitures depends upon owners or strangers coming forward to pay the taxes; it affords the collecting authorities no opportunity to take the initiative. The civil action for taxes requires painstaking individual legal actions against particular delinquents and presupposes a vigor and vigilance in the collection program that thus far has been unobtainable. The "three-officer" plan passes the same unmarketable title as the ordinary tax sale. Both the "three-officer" plan and the forfeiture foreclosures were designed to realize upon properties bearing delinquent taxes exceeding their value; instead, they have become means by which owners wipe off their taxes at a fraction of face value.

It is essential that legal methods of dealing with forfeited properties be *collection* methods. That is, they must be methods which permit the county authorities to take the initiative in effective measures to collect the taxes. They must not depend upon any action by the taxpayer (contrast the redemption and purchase of forfeitures and the forfeiture foreclosure on guaranteed bid) and must not be so impractical that the collecting authorities cannot take action (contrast the civil action). They must permit the county to realize the full priority of its tax liens (contrast the fractional recoveries under the "three-officer" plan and the forfeiture foreclosures). Only the civil action and the forfeiture foreclosure seem capable of being made *collection* methods.

This article can suggest no panacea or magic formula by which forfeited taxes can be collected without expense or effort. Rather, the experiences

[144] Report of the Revenue Laws Commission of the State of Illinois, submitted to the sixty-sixth General Assembly, p. 25 (March 1949).

in Cumberland County and elswhere suggest that forfeiture collection will require hard, expensive, painstaking work. The first prerequisite of vigorous tax collection administration is the close, whole-hearted cooperation of all county officers: the county board which has general supervisory and budget making powers; the county collector (the County Treasurer) who has prime collection responsibility; the state's attorney who must bring all legal actions; the county clerk who maintains the official collection records; the county assessor whose property ownership and valuation records will be essential material in proceeding against the large number of delinquents; and the County Housing Authority, forest preserve districts, etc., which may take charge of properties bid in by the county. The second prerequisite is the determination of these officers to use the methods now available to best advantage to collect taxes and their willingness to pay the price in allocations of personnel and funds. The third is the technical correction of defects and uncertainties in the collection methods themselves. These corrections have been touched upon in the foregoing discussion but are probably less important than determined administration.

THE NEED FOR RESEARCH IN FAMILY LAW*

MAX RHEINSTEIN†

FOR several decades the family has been a favorite field of research for American sociologists and, to some extent, for those who have been interested in building a science of social service. It has been strangely neglected, however, by American lawyers and legal scholars. On the continent of Europe, especially in France, Germany, Italy, the Scandinavian countries, and Switzerland, family law has been treated extensively and intensively for a long time, at least insofar as its technical legal aspects are in question. There are numerous treatises of high standing upon the subject, and problems of family law are continuously discussed in the legal periodicals and in those innumerable monographs which are so characteristic of continental legal literature. In this country no comprehensive treatise on family law has been published since Bishop's book of the 1850's, which is now completely obsolete. The books by Peck and Madden are meant for students' use and Vernier's comprehensive survey is limited to statute law. Scholarship has also been achieved in several casebooks, but the very nature of this type of literature forbids intensive and systematic treatment. The remaining writing consists of practitioner's handbooks, especially on divorce and community property, law review articles dealing with scattered problems, and occasional allusions to legal problems in the extensive literature of sociology and social service. Significantly, family law has not been covered in the extensive presentation of the existing American law contained in the Restatement undertaken by the American Law Institute.

Family law has never attracted that concentrated effort of the legal profession which has been lavished upon business law, constitutional law, administrative law, labor law, and other fields connected with burning political issues or the interests of powerful economic groups. Yet family law influences the lives of everybody more deeply than any of these fields. For that very reason the people interested in it have remained unorganized and thus unable to influence legislation. There are no organizations and no lobbies of illegitimate children, divorced husbands, or housewives. Perhaps the obvious neglect may also to some extent be connected with the fact that litigation concerned with family problems does not yield such large fees as litigation in the fields of corporations, business regulation, finance, and taxation.

* Report on an inquiry conducted for the Social Science Research Council.

† Max Pam Professor of Comparative Law, University of Chicago.

The general impression that legal research workers have not given family law the attention which is necessary has been confirmed by an inquiry which was undertaken in the summer of 1948 by the Social Science Research Council. While testifying to the great intensity and extensiveness of research on the social, psychological, and educational aspects of the family, the inquiry reveals research on the legal aspects to be in need of both intensification and organization.

In order to obtain a survey of the work presently being carried on, as well as an indication of the problems for future research, a questionnaire was sent to approximately four-hundred persons and organizations who were believed to be interested, or are already conducting research, in the field of family law.[1]

Seventy-eight answers were received. In spite of this limited number, the answers are so varied in origin and cover such a broad field that conclusions are possible as to the present state of interest in the field and, quite particularly, as to the needs for future research. Twenty-seven answers were completely negative, i.e., they indicated that research in the field was neither carried on nor contemplated. Even when allowance is made for the short time intervening between the mailing of the questionnaire and the date of the report, as well as for the fact that some of the addressees of the questionnaire may have been absent on their summer vacations, the conclusion seems to be justified that the majority of those addressees who have not sent answers have nothing to report. This conclusion may be drawn from the fact that those who are genuinely interested in the field invariably offered expressions of enthusiastic support for the inquiry and hopes that its publication might stimulate future work.

The positive answers received indicated that thirty-three investigations concerned with various problems of family law are presently under way,[2] and

[1] Questionnaires were sent to: 1) all teachers of family law in the member schools of the Association of American Law Schools; 2) all member schools of the American Association of Schools of Social Work; 3) all state departments of public welfare; 4) the chairmen of about sixty committees of the American Bar Association and the several State Bar Associations; 5) the United States Children's Bureau; 6) several individuals known to be interested in the field.

[2] The following table indicates the number of inquiries concerned with particular groups of problems:

Problem	No. of Inquiries	Problem	No. of Inquiries
Marital property rights	8	Guardianship	1
Divorce and non-support	8	Child welfare	1
Marriage	5	Domestic relations courts	1
Insurance and old age	1	Small estates	1
Parent-child relation	1	Instalment buying	1
Status of women	1	History, general (common law)	1
Patterns of family life	1	General treatises	1
Adoption	1		

that twenty-seven future studies are proposed.[3] Professors, especially of law schools, bar association committees, attorneys, and judges constitute three-fourths of those carrying on present studies.[4] Whether all of the studies reported as research are really deserving of that name appears doubtful. Some of them are undoubtedly of an amateurish character. This statement certainly applies to some of the studies undertaken by bar associations and similar committees, which experience shows to be composed frequently of lawyers and judges who may have practical experience as well as good intentions, but lack training in genuine research methods. In each state these committees are working independently without contact with the corresponding committees in other states, and frequently in blissful ignorance of the research carried on by competent sociologists or other non-legal experts. Yet the results of the unsystematic and haphazard "inquiries" of these committees constitute the basis of most of the state legislation in the field. Coordination and guidance by well trained research workers is urgently needed for this work.

Insofar as the addressees of the questionnaire answered the question relating to the desirable qualifications for competent research, they invariably indicated that legal training alone is insufficient and must be supplemented by training in sociology, psychology, education, or other fields. Training in psychology and religion was repeatedly mentioned as desirable. Since no single individual can be expected to be competent in all these fields, cooperation of experts is clearly indicated.

The tabulation of the answers received shows that the greatest interest in the field is presently attracted by the problems of divorce and of marital property.[5] The unsatisfactory state of the present American law of di-

[3] The following table indicates the number of inquiries proposed for particular groups of problems:

Problem	No. of Inquiries	Problem	No. of Inquiries
Divorce	8	Domestic relations courts	2
Small estates	2	General treatises	1
Parent-child relation	1	Collection of state materials	1
Termination of parental power	1	Patterns of family life	2
Adoption	1	Obsolete laws	1
Child welfare	1	Guardianship	1
Marital property	1	Desertion	1
Intra-family torts	1	Comparative law, general	1
Instalment buying	1		

[4] The following table indicates the number of inquiries being conducted by particular groups of persons or organizations:

Individuals or Organizations	No. of Inquiries	Individuals or Organizations	No. of Inquiries
Professors, especially of law schools	18	State departments of public welfare	1
Graduate students	1	United States Children's Bureau	1
Undergraduate students	2	League of Women Voters	1
Bar association committees, attorneys, and judges	9	Legal aid bureaus	
Schools of social work	1	Better Business Bureau	

[5] Notes 2 and 3 supra.

vorce has been decried so frequently and so eloquently that no further elaboration is necessary. It has also frequently been observed that no reform of the evils of the divorce law is possible without improvement of the law relating to the conclusion of marriage. The inception of hasty and ill-considered marriages is favored by the present law. The anachronism of common-law marriage still exists in almost half of the states of the country. The system of formal marriage and licensing is in most states ineffective to prevent those marriages which society, for various reasons, regards as intolerable or undesirable; it is not even effective to prevent bigamy, and the rules designed by the courts to deal with this unhealthy situation are cumbersome, unsystematic, and uncertain. Legislative provisions designed to prevent socially undesirable marriages, especially marriages of people of immature age or of those afflicted with disease, are haphazard and technically deficient, and attempts by several states to establish more satisfactory provisions in this respect have been rendered ineffective by the chaotic state of the conflict of laws, which favors the easy evasion of restrictive marriage regulations.

While these problems have received some attention, much less interest has been shown in the equally unsatisfactory state of the relations of the married couple to the outside world. Under the pressure of the feminist movement, all states have enacted laws designed to emancipate married women from the domination of the husband. Much of this legislation has gone so far, however, as to neglect the fact that the family, after all, still constitutes a social unit. Especially with respect to property relations, husband and wife are treated in the majority of states as if they were complete strangers to each other. Under the system of separation of assets, as it has been developed by modern Married Women's Property Laws, the husband owns his property and the wife hers, and the fact that in numerous, perhaps the majority of all families, husband and wife pool their assets, is neglected. In consequence, grave difficulties have arisen with respect to the relations of a married couple to its creditors, both contractual and delictual, in the treatment of the assets upon the death of one of the spouses, in the case of divorce, and, quite particularly, in the case of bankruptcy. Remedies such as family expense laws or presumptions as to the ownership of assets have been unsystematic and unsatisfactory. The present system of separation of assets developed historically on the basis of those rules which were elaborated in the 18th century by the English equity courts for people of considerable wealth. In consequence, while fitting well the needs of people in the top brackets of the property and income structure, the present law is ill-suited for the middle classes, the

workers, and the farm population. At present, however, nobody knows what the needs of the lower income groups are, how well or how badly they are served by the existing law, or what improvements could be made. Factual research on the present methods of handling property matters by married couples in the various groups of the population is needed. Such research might well indicate that the present idea of having available only one system of property regulation for all groups of the population is insufficient, and that existing needs might be served better by a law which, like that of most European countries, presents married couples with a choice between various systems of property regulation.

The evil of enforced uniformity exists also in those Western and Southern states which have adopted the system of community property, under which marriage is regarded as a partnership in which the earnings of either spouse constitute a common fund belonging equally to both. The idea underlying this system seems to be more in accord with realities, especially of middle class life, than that underlying the majority system of separation of assets. However, in all community property states the basic simple idea has been encumbered with unsystematic legislation of detail, which not only varies from state to state but also results in difficulties and unnecessary litigation, especially in the relations to creditors of one spouse or the other, or when it becomes necessary to partition the community fund. The situation has been aggravated by the recent trend to adopt the community property system solely for the income tax advantages which were connected with it until the 1948 amendment of the Code of Internal Revenue.

One of the principal features of the Married Women's Property Acts, which have been gradually enacted in the several states since the 1850's, has been the grant to married women of the capacity to enter into contracts and to make dispositions of their property. However, in numerous states this legislation has been incomplete. In quite a few places married women cannot make gifts, cannot undertake to be a surety either for the husband alone or for any other debtor, cannot enter into partnership agreements with the husband, or cannot make any transactions with the husband at all. The motive of such limitations of contractual capacity has not been the desire to protect married women against supposed domination by the husband, but rather to protect families against complete financial ruin. Where the wife cannot be a business partner or surety for the husband, some assets of the family can be salvaged in case of the husband's financial breakdown and a new financial start can be made by the family.

The same desire to protect families from complete financial collapse underlies the preservation in numerous states of the Middle West, West, and South of the ancient institution of dower. Insofar as one spouse has a dower estate in the assets of the other, it cannot be taken into execution by the latter's creditors, and even during the latter's lifetime the dower estate cannot be affected in a forced sale. However, dower may be signed away and operates only with respect to immovable property. In recent years legislators seem to have lost sight of the protective functions of the so-called incapacities of married women as well as of the institution of dower. Legislation aimed at the abolition of these incapacities or of dower has been recommended or adopted in several states upon arguments concerned exclusively with the equality of the sexes or with the hampering effects of dower on real estate transactions. Without full consideration of the problems involved, such legislation must of necessity be unsuccessful and result in surprises.

Where dower has been abolished, it has been supplanted by an "indefeasible share" of the surviving spouse in the estate of the predeceasing, such as has long existed with respect to movable assets. Such an indefeasible share can easily be defeated, however, by inter-vivos transactions unless there are established proper safeguards, especially against transactions designed to defraud the surviving spouse of his or her share. The legislative and judge-made rules against such defeasance have so far been incomplete and ineffective. The long experience of civil law countries in this respect and the exemplary solutions of the problem elaborated in their laws have been neglected.

Under the ancient common law, a law suit could not be maintained between husband and wife or between a parent and his minor children. Modern legislation has mitigated this antiquated rule. Difficulties have arisen, however, with respect to personal injury suits. Following the modern trend, numerous courts, anxious to be liberal, have allowed such suits; but in so doing they have overlooked the fact that these suits are really directed not against the other spouse but against the liability insurer. The result has been a confusion between liability and accident insurance. The results may be socially desirable, but no final judgment can be ventured without an extensive investigation of the underlying facts, especially the influence of the new rule upon insurance rates. Needless to say, no such investigation has been undertaken to date.

With respect to purchases made for family needs by the wife, the ancient rule is that the wife is regarded as the agent of the husband and that the husband is the only party liable upon such purchases and other similar

transactions. However, the scope of this agency of the wife is uncertain; the sole liability of the husband has also been found sometimes to endanger the interests of the suppliers of goods which are consumed or used not only by the husband but also by the wife and other members of the family. In some states organized groups have succeeded in obtaining the enactment of Family Expense Laws, under which the liability of the wife is added to that of the husband. Again, however, the scope of such added liability is poorly defined, and research into the needs for, and the effects of, such legislation is called for.

In the case of breakdown of a family, the existing law provides a variety of remedies for the enforcement of the claims of the wife and the children for support or alimony. These remedies vary from state to state and their efficiency is insufficiently guaranteed, especially in those cases in which the claimant or claimants and the defaulting husband or father are living in different states. Research into the present structure and its effectiveness is indispensable as a preparation for a more satisfactory regulation.

Numerous and important reciprocal rights result from the relation between parent and child. The enforcement of such rights presupposes, however, the establishment of the existence of the parent-child relation. Presumptions of fatherhood and other rules of evidence are concerned with this problem. Here also, there are unsystematic differences in the laws of the different states. Even greater differences exist with respect to those institutions which substitute an artificial for the natural parent-child relation, i.e., adoption and legitimation. To what extent, if any, such differences are justified and to what extent the various state laws fulfill the existing social needs cannot be ascertained without intensive factual research.

The severe critique already expressed with respect to the present divorce laws must be applied equally to the law dealing with illegitimate children. The legislation still existing in numerous states cannot be called anything but a disgrace. Radical reforms are a crying need, but should not be undertaken without previous research, which should consider the exemplary legislation of several foreign countries, especially Germany, Austria, and the Scandinavian countries.

Important needs should be fulfilled by the institution of guardianship, which for centuries has been designed to protect the personal and property interests of orphans or children whose parents are unable or unfit to take proper care of them, or of insane and other adult persons who are unable to take proper care of their own affairs. Few fields of law have been so neg-

lected, however, as that of guardianship. Even the basic legal concepts are ill-defined, and the judicial machinery for the appointment and supervision of guardians does not seem to work properly.

Quite a few other problems could be added to the foregoing list. It is long enough, however, to indicate the unsatisfactory state of the present American family law. The need for more intensive treatment is burning. Just because of its long neglect, American family law is more unsatisfactory than any other field of the law. Not only is it devoid of dogmatic elaboration, but its present rules are to a large extent obsolete, unsystematic, and dependent on the accidental whimsies of insufficiently informed legislators or judges. In a report recently submitted by representatives of the American Bar Association to the White House Conference on Family Life, the present divorce laws were called an absurdity and a disgrace. The same epithets could be applied to most other branches of family law. Legislative reforms are indicated for every aspect of the field. More harm than good would be done, however, if such reforms were undertaken, as they have been so far, without sufficient basic research, which ought to be directed both at the elucidation of the existing legal rules and at their effects upon actual family life and social structure. All the various problems are, of course, interrelated. While detailed research is needed for every single one of them, such research should be coordinated if maximum results are to be expected. In recent years the American Law Institute has undertaken a large-scale inventory of the existing American law, but the field of family law has not been included. The gap thus left ought to be filled. Because of the existing uncertainties, the work to be undertaken cannot be limited to a restatement of the existing family law, important though such work is. What ought to be undertaken is an extensive, systematic, and complete inquiry into all those needs which the family law is meant to satisfy, the extent to which these needs are satisfactorily taken care of at present, and the probably much greater extent to which the present law is unsatisfactory. We ought to know the underlying facts; we must try to find out the impact, desirable or undesirable, of present or proposed legislation; we must find out how identical needs are taken care of in those foreign countries which have given more attention to them in the past than has this country; and, on the basis of all such inquiries, there should be elaborated a set of model laws to be recommended to the states for adoption. Finally, if and when all this work has been done, a powerful organization should be created for the educational and other efforts necessary to assure the adoption of such legislation.

Obviously such a task cannot be undertaken by lawyers alone, but only

by an organization in which lawyers can cooperate with other experts in the field of the family, i.e., sociologists, social workers, educators, representatives of home economics, tax experts, theologians, moral philosophers, and last, but not least, plain individuals with a sense of civic responsibility. Obviously too, such a task requires organization. A model is furnished by the American Law Institute. For the preparation of its Restatements as well as of its Model Codes of Evidence, Criminal Procedure, and Juvenile Delinquency, the Institute parceled out the work among the leading scholars in the various fields. Each one of these "reporters" was aided by a small group of experts, who carefully scrutinized the reports and drafts prepared by the reporters until, after repeated revision and redrafting, they appeared satisfactory to these groups. Each draft was thereupon submitted to the Council of the Institute, which consists of high-ranking judges and leading members of the Bar. After approval by the Council the drafts were submitted for final approval to the full membership of the Institute, which meets once every year for this task. Quite possibly, the American Law Institute might lend its well-established organization for the new task, enlarged in the manner indicated above. Possibly, however, the task might also be undertaken by some existing organization of sociologists or social workers or by some new organization which would have to be especially created. Until an over-all research body has been created, an effort should be made at least to coordinate the current work of those preparing state legislation.[6]

[6] The National Council on Family Relations or the National Council on State Legislation might well undertake to initiate this work.

THE UNIVERSITY OF CHICAGO LAW REVIEW

VOLUME 16 SUMMER 1949 NUMBER 4

BOARD OF EDITORS

JAMES J. MCCLURE, JR., *Editor-in-Chief*

WILLIAM S. BOYLSTON
THEODORE W. DE LOOZE
ABRAHAM KRASH
HARRY PRATTER
ROBERT L. RANDALL
MILTON L. RAY

Associates

ARNOLD M. FLAMM
NORMAN GEIS
MILDRED J. GIESE
RAYMOND GOETZ
EDWIN H. GOLDBERGER
MARVIN GREEN
MILES JAFFE
VIRGINIA A. LEARY
GEORGE W. MCBROOM
RICHARD H. PRINS
JEROME W. SANDWEISS
FREDERICK MAX SCHUETTE
BERNARD H. SIEGAN
HENRY L. STERN
SHERWIN J. STONE
C. RICHARD WALKER
MARY JANE S. WATT

ROBERT W. CROWE, *Business Editor*
MAX M. DERRY, *Associate*

E. W. PUTTKAMMER, *Faculty Adviser*

NOTES

FREE SPEECH AND PICKETING FOR "UNLAWFUL OBJECTIVES"

The constitutional status of the right to picket has been a fruitful source of controversy since peaceful picketing was identified with freedom of speech in *Thornhill v. Alabama*.[1] Only two years after Justice Murphy had written the *Thornhill* decision, Justice Frankfurter led a majority of the Supreme Court on a retreat which culminated in the *Ritter's Cafe*[2] case. The Court wavered at this halfway house until 1943, and then abandoned its leadership by refusing to review any more picketing cases.[3] The recent decision in *Giboney v. Empire Storage & Ice Company*[4] marks the first full statement on picketing from the Supreme Court in six years. In an effort to organize nonunion ice peddlers, an ice truck drivers union obtained agreements from Kansas City ice wholesalers to refrain from selling ice to independent peddlers. Upon the refusal of the Empire Storage & Ice Company to execute such an agreement a picket line was thrown around the company's place of business. Truck drivers working for Empire's customers refused to cross the picket line, thereby cutting off 85% of the company's busi-

[1] 310 U.S. 88 (1940). Note also the companion case, Carlson v. California, 310 U.S. 106 (1940).

[2] Carpenters & Joiners Union of America v. Ritter's Cafe, 315 U.S. 722 (1942). The Ritter case has been widely regarded as a qualification of the original Thornhill doctrine. See Gregory, Labor and the Law 361 (1948); Armstrong, Where Are We Going with Picketing?, 36 Calif. L. Rev. 1 (1948); Teller, Picketing and Free Speech, 56 Harv. L. Rev. 180 (1942).

[3] Prior to the Giboney case the last full picketing case was Cafeteria Employees Union v. Angelos, 320 U.S. 293 (1943). Certiorari was subsequently denied in the following picketing cases: Fred Wolferman, Inc. v. Root, 356 Mo. 976, 204 S.W. 2d 733 (1947), cert. den. 333 U.S. 837 (1948); Hotel & Restaurant Employees International Alliance v. Greenwood, 249 Ala. 265, 30 So. 2d 696 (1947), cert. den. 332 U.S. 847 (1948); Wisconsin Employment Relations Board v. Milk & Ice Cream Drivers Union, 238 Wis. 379, 299 N.W. 31 (1941), cert. den. 316 U.S. 668 (1942). In Denver Milk Producers, Inc. v. International Brotherhood of Teamsters, 116 Colo. 389, 183 P. 2d 529 (1947), appeal dismissed 334 U.S. 809 (1948), the Supreme Court declined to review the Colorado court's order restraining secondary peaceful picketing. With Justices Black and Murphy dissenting, the Court announced per curiam: "Because of the inadequacy of the record, we decline to decide the constitutional issues involved. The appeal is dismissed without prejudice to the determination in further proceedings of any questions arising under the federal Constitution." Ibid., at 809. In U.S. v. Petrillo, 332 U.S. 1 (1947), the Court again declined to pass on the constitutionality of a statute applied to prevent a featherbedding picket. The lower court had declared the statute unconstitutional. 68 F. Supp. 845 (D.C. Ill., 1946). But the Supreme Court considered it "inappropriate to reach the merits of this constitutional question now. As we have pointed out, we have consistently said that we would refrain from passing on the constitutionality of statutes in advance of the necessity to do so." U.S. v. Petrillo, 332 U.S. 1, 10 (1947).

[4] 69 S. Ct. 684 (1949).

ness. Empire obtained an injunction on its complaint that the efforts of union members to restrain Empire from selling to nonunion drivers were in violation of the Missouri anti-trade restraint statute, and that an agreement by Empire to refuse to make such sales would violate the same statute. The state Supreme Court affirmed, agreeing that the picketing was designed to force Empire to become a party to an unlawful transportation combination, and that the injunction to prevent picketing for such an unlawful purpose did not contravene the union's right of free speech. The United States Supreme Court, through Justice Black, unanimously affirmed the state court decision on the ground that the *Thornhill* doctrine did not "exten[d] its immunity to speech or writing used as an integral part of conduct in violation of a valid criminal statute."[5] *Giboney v. Empire Storage & Ice Company* supplements the *Ritter's Cafe* case and confirms the line of authority well established in the state courts that peaceful picketing for unlawful objects is not protected by the guarantees of the *Thornhill* doctrine. But whether any vestiges of *Thornhill v. Alabama* can in fact be salvaged from the *Giboney* case invites discussion.

I

The *Thornhill* case and its companion decision, *Carlson v. California*,[6] involved blanket statutory proscriptions of all picketing. In holding these state laws invalid, the Court relied upon an earlier dictum of Juctice Brandeis[7] to convert picketing from a tolerated privilege into a full-fledged constitutional right. Speaking for the Court, Justice Murphy announced that "[i]n the circumstances of our times the dissemination of information concerning the facts of a labor dispute must be regarded as within that area of free discussion that is guaranteed by the Constitution."[8] Justice Murphy's meaning was clarified the following year, when the Court handed down the decision of *AFL v. Swing*.[9] A beauty workers' union had attempted to unionize Swing's beauty parlor by peaceful picketing. Swing obtained an injunction on the ground that there was no immediate employer-employee dispute involved. On appeal the Court reaffirmed the *Thornhill* rule and held that, in the absence of legislation, state courts could not restrict a union's right of free speech simply "by drawing the circle of economic competition between employers and workers so small as to contain only an employer and those directly employed by him."[10]

[5] Ibid., at 688.

[6] 310 U.S. 106 (1940).

[7] In Senn v. Tile Layers Protective Union, 301 U.S. 468 (1937), the Court decided that pro-picketing legislation did not deprive an employer of due process of law or of equal protection of the laws. But Justice Brandeis uttered an equivocal statement in the course of the decision which has been widely misinterpreted. "Members of a union might, without special statutory authorization by a State, make known the facts of a labor dispute, for freedom of speech is guaranteed by the constitution." Ibid., at 478.

[8] Thornhill v. Alabama, 310 U.S. 88, 102 (1940).

[9] 312 U.S. 321 (1941). The same day, in Milk Wagon Drivers Union of Chicago v. Meadowmoor Dairies, 312 U.S. 287 (1941), the Court established that picketing "in the context of violence" was not protected by the guarantees of the Thornhill doctrine.

[10] AFL v. Swing, 312 U.S. 321, 326 (1941).

The holding of the *Swing* case was amplified in *Bakery and Pastry Drivers Local v. Wohl.*[11] In an effort to compel independent pastry peddlers to employ union relief drivers, a truck drivers union picketed bakeries which were supplying the independents. Since the peddlers were self-employed, the trial court had issued an injunction on the ground that there was no labor dispute. The Court reiterated the rule of the *Swing* case, stating that the absence of a labor dispute as defined by state law did not impair the union's constitutional rights under the Fourteenth Amendment. But while token respect was paid to freedom of speech, the Court also indicated that picketing was subject to restrictions not clearly encompassed within orthodox free speech doctrine.[12] These caveats to the *Wohl* case were elevated to holdings in *Carpenters & Joiners Union of America v. Ritter's Cafe.*[13] A building contractor was erecting a building for Ritter under a contract which did not require employment of union labor. The defendant union picketed a cafe owned by Ritter to compel the hiring of union workers by the contractor. This picketing was enjoined as violating the state anti-trust law, and the Supreme Court affirmed the injunction five to four. Speaking for the majority, Justice Frankfurter declared that the states could lawfully confine the "sphere of communication" within the "economic context of the real dispute." The Court thus implied that the organized carpenters were constitutionally protected in picketing nonunion building operations, but not enterprises outside the building industry. In preference to a clear-and-present-danger approach, the Court employed a unity-of-interest rationale to distinguish the *Wohl* case from the *Ritter* case.[14] In so rejecting the free speech touchstone of *Thornhill v. Alabama*, the *Ritter* case has been regarded as a major qualification of the basic *Thornhill* doctrine.[15]

The Supreme Court's decision this year in the *Giboney* case will undoubtedly add fuel to the controversy engendered by the *Ritter's Cafe* decision. This con-

[11] 315 U.S. 769 (1942).

[12] "A state is not required to tolerate in all places and all circumstances even peaceful picketing by an individual. But so far as we can tell, respondents' mobility and their insulation from the public as middlemen made it practically impossible for petitioners to make known their legitimate grievances to the public whose patronage was sustaining the peddler system except by the means here employed and contemplated; and those means are such as to have slight, if any, repercussions upon the interests of strangers to the issue." Ibid., at 775. In a concurring opinion, Justice Douglas commented: "If the opinion in this case means that a State can prohibit picketing when it is effective, but may not prohibit it when it is ineffective, then I think we have made a basic departure from Thornhill v. Alabama." Ibid., at 775.

[13] 315 U.S. 722 (1942). The Ritter and Wohl cases were decided the same day.

[14] "The dispute there related to the conditions under which bakery products were sold and delivered to retailers. The business of the retailers was therefore directly involved in the dispute. In picketing the retail establishments, the union members would only be following the subject-matter of their dispute." Carpenters & Joiners Union of America v. Ritter's Cafe, 315 U.S. 722, 727 (1942). A similar problem arose in Allen-Bradley Local v. Wisconsin Employment Relations Board, 315 U.S. 740 (1942), where a union picketed the homes of nonstriking employees. However the case was decided on other grounds.

[15] Note 2 supra.

troversy will be intensified by the fact that Justice Black's opinion is susceptible to divergent interpretations. Some critics will read the decision as holding that picketing by the union drivers was itself a violation of the anti-trade restraint statute.[16] Others will contend that inducing Empire to violate the Missouri statute was in substance a criminal solicitation.[17] Or it may be urged that the picketing was intrinsically lawful, but was tainted with an "illegal purpose."[18] If the unlawful-object[19] approach underlies the *Giboney* case, the *Thornhill* doctrine would require that the accomplishment of the union's illegal purpose threaten a clear and present danger of substantive evil. Consideration of the probable success of the picketing and the offensiveness of its "object" would be vital factors in the decision. Such consideration, if present in the *Giboney* case, was cast only in veiled language.[20] Justice Black's opinion thus leaves undetermined the area of state discretion in defining unlawful objects. If picketing is still to be an exercise of simon-pure free speech, the "objects" would have to be tested by clear-and-present-danger techniques. If picketing is pure economic warfare, the guiding principle would be public policy in defining the allowable area of economic conflict. If picketing is a hybrid activity, some fair method should be developed to differentiate the privileged from the unprivileged. Presuming some identification of the peaceful picket with free speech, how far can picketing be restricted by declaring its purposes illegal?

[16] "Thus all of appellants' activities . . . constituted a single and integrated course of conduct, which was in violation of Missouri's valid law. In this situation, the injunction did no more than enjoin an offense against Missouri law, a felony." Giboney v. Empire Storage & Ice Company, 69 S. Ct. 684, 688 (1949).

[17] The gravamen of the offense here would be that the picketing "was to induce Empire to violate the Missouri law by acquiescing in unlawful demands to agree not to sell ice to nonunion peddlers." Giboney v. Empire Storage & Ice Company, 69 S. Ct. 684, 690 (1949). Fox v. Washington, 236 U.S. 273 (1915), a solicitation case, was relied upon in this section of the Court's argument. The opinion of the Missouri court, which was adopted by the Supreme Court, emphasized that inducing Empire to violate the anti-trade restraining statute was the gist of the union's illegal conduct.

[18] The Court regarded the picketing merely as an incident of the union's transportation combination, and consequently refused to consider it "in isolation." Similarly, the Court argued that "we can[not] say that the publication here should not have been restrained because of the possibility of separating the picketing conduct into illegal and legal parts." Giboney v. Empire Storage & Ice Company, 69 S. Ct. 684, 690 (1949). The inference seems to be that the picketing would have been lawful, if regarded "in isolation."

[19] The illegal-purpose approach to picketing has dictum support from the Wohl case. Counsel for the vendors had contended that a subsequent decision of the New York Court of Appeals established the rationale of the injunction as based on the unlawful-object doctrine. This was ignored because it "lack[ed] the deliberateness and formality of certification, and was uttered in a case where the question of the existence of a right to free speech was neither raised nor considered." Bakery & Pastry Drivers Local v. Wohl, 315 U.S. 769, 774 (1942).

[20] "There was clear danger, imminent and immediate, that unless restrained, appellants would succeed in making that policy [of the Missouri law] a dead letter insofar as purchases by nonunion men were concerned." Giboney v. Empire Storage & Ice Company, 69 S. Ct. 684, 691 (1949).

II

The pre-eminence of the unlawful-object test in the state courts is largely due to the doctrine enunciated in the *Swing* and *Wohl* cases. Judges who had maintained that local anti-injunction acts were the only bars to the restriction of picketing, were informed by the Supreme Court that peaceful picketing was immune from the injunction irrespective of such legislation. Presumably the absence of a state-defined labor dispute did not open the door to injunctive relief unless the picketing could be brought within the scope of the *Ritter's Cafe* decision. The unlawful-object test thus furnished a convenient alternative for those courts which did not approve of the *Thornhill* doctrine. Without openly defying the Supreme Court, these courts could still argue that lawful means could not be used to support unlawful ends.

This revival of the unlawful-object rationale also had its disadvantages. The definition of "object" has always been a source of much confusion to the courts. A great body of distinctions has been built up to differentiate motive, purpose, and intention, as well as to account for "immediate" and "ultimate" objects.[22] The necessity of extracting "purpose" from a vast continuum of means and ends led to great uncertainty in the picketing cases. The Missouri Supreme Court held that picketing could be enjoined when a lawful and unlawful purpose were "coupled" together,[23] while in Oregon a combination of lawful and unlawful purposes was privileged.[24] The California Supreme Court authorized peaceful picketing for unlawful objects which were "means" to lawful ends,[25] although in a later case it was conceded that "the public interest may tip the scales one way or another."[26] In the majority of cases the courts have chosen without explanation the objective to be tested.[26]

Even when union purpose has been established, the basic problem of legality must still be met. The decisions reflect standard problems which arise in the judicial definition of the allowable area of economic conflict. In the teeth of the *Thornhill* doctrine, the state courts have been surprisingly uniform in subjecting picketing to the same scrutiny as other devices of union pressure. The manner in

[22] Rest., Torts § 777 Comment a (1939); 1 Teller, Labor Disputes and Collective Bargaining § 66 (1940).

[23] Fred Wolferman, Inc. v. Root, 356 Mo. 976, 204 S.W. 2d 733 (1947), cert. den. 333 U.S. 837 (1948).

[24] Peters v. Central Labor Council, 179 Ore. 1, 169 P. 2d 870 (1946).

[25] Park & Tilford Import Corp. v. International Brotherhood of Teamsters, 27 Cal. 2d 599, 165 P. 2d 891 (1946). Compare Burlington Transportation Co. v. Hathaway, 234 Ia. 135, 12 N.W. 2d 167 (1943).

[26] Northwestern Pac. Ry. Co. v. Lumber & Sawmill Workers Union, 31 Cal. 2d 441, 189 P. 2d 277 (1948).

[26] The American Law Institute has submitted a definition of "object" which avoids the typical difficulties: "An 'object' of concerted action by workers against an employer is an act required in good faith by them of the employer as the condition of their voluntary ceasing their concerted action against him." Rest., Torts § 777 (1939).

which the closed-shop picket has been handled discloses varied approaches to picketing regulation. The typical situation arises when a minority or outside union pickets an open-shop or a nonunion employer to compel him to sign a closed-shop contract. Some courts, notably those of Massachusetts,[27] have simply declared the closed shop an unlawful object, and have enjoined the picketing without further comment.[28] Other courts have obtained the same result by defining "labor dispute" narrowly enough to preclude the application of local anti-injunction acts, thus ignoring the Supreme Court's mandate in the *Swing* case.[29] More ingenious courts have argued that minority unions may not picket to compel breach of the employers' statutory duty to contract only with the majority representative.[30] Courts upholding the closed-shop picket have generally done so because the object was deemed lawful rather than on free speech grounds.[31]

A related purpose served by picketing is the protest of contracts or certification awarded a rival union. Some courts have proceeded on the theory that the absence of a labor dispute opens the door to injunctive relief.[32] Certification of a rival union is thus held to terminate the minority's privilege of applying further pressure, supposedly because the minority is not a competent party to a "labor dispute." Where the *Thornhill* doctrine is taken more seriously, courts have relied on unlawful-object principles. Thus it is held an illegal purpose to frustrate the statutory mechanism of majority rule by defying the rival union's certification.[33] On the other hand, where picketing is permitted, the distinction is drawn be-

[27] David Bros. Fisheries v. Pimental, 78 N.E. 2d 93 (Mass., 1948); Colonial Press v. Ellis, 321 Mass. 495, 74 N.E. 2d 1 (1947); Fashioncraft v. Halperin, 313 Mass. 385, 48 N.E. 2d 1 (1943).

[28] In Consumers Sand & Gravel Co. v. Kalamazoo Bldg. Council, 321 Mich. 361, 32 N.W. 2d 531 (1948), a closed-shop picket was held unlawful under a "right to work" statute.

[29] Gazzam v. Building Service Union, 29 Wash. 2d 488, 188 P. 2d 97 (1947); Markham & Callow v. International Woodworkers of America, 170 Ore. 517, 135 P. 2d 727 (1943); Shively v. Garage Employees Local Union, 6 Wash. 2d 560, 108 P. 2d 354 (1940). In AFL v. Bain, 165 Ore. 183, 106 P. 2d 544 (1940), a statute prohibiting picketing in the absence of a "bona fide labor dispute" was held unconstitutional.

[30] Fred Wolferman, Inc. v. Root, 356 Mo. 976, 204 S.W. 2d 733 (1947), cert. den. 333 U.S. 837 (1948); R. H. White Co. v. Murphy, 310 Mass. 510, 38 N.E. 2d 685 (1942).

[31] Iacomnis Restaurant v. Hotel & Restaurant Employees Local, 16 C.C.H. Lab. Cas. ¶65080 (Ohio Ct. Com. Pls., 1948); Park & Tilford Import Corp. v. International Brotherhood of Teamsters, 27 Cal. 2d 599, 165 P. 2d 891 (1946); Twitchell-Champlin Co. v. Conary, 11 C.C.H. Lab. Cas. ¶63483 (Super. Ct. Me., 1946); East Lake Drug Co. v. Drug Clerks Union, 298 N.W. 722 (Minn., 1941).

[32] North East Texas Motor Lines v. Dickson, 16 C.C.H. Lab. Cas. ¶65054 (Tex. S. Ct.; 1949); Gulf Oil Corporation v. Smallman, 270 App. Div. 129, 58 N.Y.S. 2d 495 (1945), Floraheim Shoe Store Co. v. Retail Shoe Salesman's Local, 288 N.Y. 188, 42 N.E. 2d 480 (1942); Bloedel Donovan Lumber Mills v. International Woodworkers of America, 4 Wash. 2d 62, 102 P. 2d 270 (1940).

[33] Swenson v. Seattle Central Labor Council, 27 Wash. 2d 193, 177 P. 2d 873 (1947); Serval Slide Fasteners v. Molfetta, 188 N.Y. Misc. 787, 70 N.Y.S. 2d 411 (1947). The same principle has been employed to restrict the right to strike. See Majority Rule and the Right To Strike, 16 Univ. Chi. L. Rev. 307 (1949).

tween persuasion of the employer to deal with the minority union, and recruiting employees for organizational purposes. The *Swing* case is thus appropriately invoked, and picketing is deemed an exercise of the right of free speech.[34] The recruiting picket has generally been well received by the courts on the ground that spreading the benefits of collective bargaining is a legitimate labor objective.[35] Objectives tainted with color discrimination have been declared unlawful on each of the occasions upon which the issue has arisen.[36] Finally, there is a large class of cases enjoining picketing for objects which have been declared illegal by statute. State anti-trust legislation has been invoked to enjoin picketing designed to enforce secondary boycotts,[37] and similar results have been obtained under the Taft-Hartley Act.[38]

[34] State v. Superior Court, 24 Wash. 2d 314, 164 P. 2d 662 (1945); Blossom Dairy Co. v. International Brotherhood of Teamsters, 125 W.Va. 165, 23 S.E. 2d 645 (1942); Culinary Workers Local v. Busy Bee Cafe, 57 Ariz. 514, 115 P. 2d 246 (1941). During the war, however, one court enjoined a minority union picket of an employer who had entered into a union-shop agreement with a rival union, on the ground that "[o]ne of the substantive evils which Congress has a right to prevent and for the prevention of which the power of the nation is now being asserted, is the breakdown of productive processes in the time of national emergency." Markham & Callow v. International Woodworkers of America, 170 Ore. 517, 135 P. 2d 727 (1943).

[35] Standard Grocer Co. v. Local No. 406, AFL, 321 Mich. 276, 32 N.W. 2d 519 (1948); Hennigh v. International Brotherhood of Teamsters, 11 C.C.H. Lab. Cas. ¶63094 (D.C. Colo., 1946); Denver Local Union v. Buckingham Transportation Co., 108 Colo. 419, 118 P. 2d 1088 (1941). However in Denver Milk Producers, Inc. v. International Brotherhood of Teamsters, 116 Colo. 389, 183 P. 2d 529 (1947), appeal dismissed 334 U.S. 809 (1948), such picketing was enjoinable because the absence of an employer-employee relationship precluded the existence of a labor dispute. Compare Silkworth v. Local 575, AFL, 309 Mich. 746, 16 N.W. 2d 145 (1944). The Texas Supreme Court recently held that a statute limiting picketing to controversies between an employer and the majority representative of his employees was unconstitutional. International Union of Operating Engineers v. Cox, 16 C.C.H. Lab. Cas. ¶65053 (Tex. S. Ct., 1949).

[36] Hughes v. Superior Court, 15 C.C.H. Lab. Cas. ¶64824 (Calif., 1948), cert. granted 69 S. Ct. 930 (1949); James v. Marinship Corp., 25 Cal. 2d 721, 155 P. 2d 329 (1944).

[37] Turner v. Zanes, 206 S.W. 2d 144 (Tex. Civ. App., 1947); cf. Giboney v. Empire Storage & Ice Company, 69 S. Ct. 684 (1949); Harper v. Brennan, 311 Mich. 489, 18 N.W. 2d 905 (1945).

[38] Section 8(b)(4)(A) provides: "It shall be an unfair labor practice for a labor organization or its agents . . . to induce or encourage the employees of any employer to engage in, a strike or a concerted refusal . . . to perform any services, where an object thereof is . . . forcing or requiring any employer . . . to cease doing business with any other person." 61 Stat. 136–61 (1947), 29 U.S.C.A. § 151 et seq. (1947). The courts have not hesitated to apply this section to picketing. United Brotherhood of Carpenters & Joiners v. Sperry, 15 C.C.H. Lab. Cas. ¶64814 (C.A. 10th, 1948); Printing Union v. LeBaron, 23 L.R.R.M. 2145 (C.A. 9th, 1948); LeBus v. Pacific Coast Marine Firemen Assoc., 15 C.C.H. Lab. Cas. ¶64794 (D.C. La., 1948). Compare Douds v. Metropolitan Federation of Architects, 75 F. Supp. 672 (N.Y., 1948). Section 8(c) provides that "[t]he expressing of any views, argument, or opinion . . . shall not constitute or be evidence of an unfair labor practice under any of the provisions of this Act, if such expression contains no threat of reprisal or force or promise of benefit." But the legislative history of this section indicates that it was designed primarily to safeguard employer free speech. Conference Report, H.R. 510, 80th Cong. 1st Sess. (1947). See H.R. 245, 80th Cong. 1st Sess. (1947). "In brief outline, the bill accomplishes the following: . . . (13) It outlaws picketing of a place of business where the proprietor is not involved in a labor dispute with his employees."

The overwhelming affirmation of the unlawful-object test in the state courts has now the blessings of a Supreme Court which unanimously affirmed the *Giboney* case. In the face of this green light from the Supreme Court, how far will they now extend the unlawful-object test? Previous application of the illegal purpose technique has divided the state courts into three camps: 1) those which have not questioned state power to define unlawful objects,[39] 2) those adopting a balance-of-equities approach to measure the asserted illegality against "the requirement of competition and some measure of equality in the economic struggle between the seller and the producer of services,"[40] and 3) those few courts which have tested the prohibited objects for "substantive evils" which would justify restriction of free speech.[41]

Perhaps the significant factor which explains the continued vitality of the unlawful-object test in the picketing cases, is the strength it draws from the orthodox common law of verbal regulation. The law of criminal solicitations has long recognized that speech for illegal purposes is punishable,[42] although the use of the injunction raises the special problem of previous restraint.[43] The critical problem lies in locating the area of state discretion in creating unlawful objects. Six basic illegal ends have hitherto been significant: 1) inducing breach of contract,[44] 2) inducing the employer to commit an unfair labor practice or to violate other statutory duties,[45] 3) inducing violation of anti-trust acts,[46] 4) induc-

[39] The Massachusetts cases are the outstanding examples. Note 27 supra.

[40] Northwestern Pac. Ry. Co. v. Lumber & Sawmill Workers Union, 31 Cal. 2d 441, 189 P. 2d 277 (1948); Shively v. Garage Employees Local Union, 6 Wash. 2d 560, 108 P. 2d 354 (1940); cf. Saveall v. Demers, 322 Mass. 70, 76 N.E. 2d 12 (1947).

[41] State v. Superior Court, 24 Wash. 2d 314, 333, 164 P. 2d 662, 672 (1945). "Peaceful picketing is a manifestation of the exercise of freedom of speech and it can be restrained only upon those grounds and conditions which warrant restraint in any other case involving freedom of speech." See also Ex Parte Waltrip, 207 S.W. 2d 872 (Tex. Crim. App., 1948); Markham & Callow v. International Woodworkers of America, 170 Ore. 517, 135 P. 2d 727 (1943).

[42] See Verbal Acts and Ideas—the Common Sense of Free Speech, 16 Univ. Chi. L. Rev. 328 (1949); Curran, Solicitation: A Substantive Crime, 17 Minn. L. Rev. 499 (1933); Fox v. Washington, 236 U.S. 273 (1915). But see Winters v. New York, 333 U.S. 507 (1948).

[43] Near v. Minnesota, 283 U.S. 697 (1931). However, in Carpenters & Joiners Union of America v. Ritter's Cafe, 315 U.S. 722 (1942), the issue was not even raised. Moreover the Court has made it clear that libellous picketing is enjoinable, although allowance must be made for "conventional give-and-take in our economic and political controversies. . . ." Cafeteria Employees Union v. Angelos, 320 U.S. 293 (1943).

[44] International Association of Machinists v. Downtown Employees, 13 C.C.H. Lab. Cas. ¶64053 (Tex. Civ. App., 1947); Chattanooga Blowpipe & Roofing Co. v. Sheet Metal Workers Local, 12 C.C.H. Lab. Cas. ¶63706 (Tenn., 1947); Gulf Oil Corp. v. International Brotherhood of Teamsters, 185 N.Y. Misc. 409, 57 N.Y.S. 2d 24 (1945).

[45] Fred Wolferman, Inc. v. Root, 356 Mo. 976, 204 S.W. 2d 733 (1947), cert. den. 333 U.S. 837 (1948); Serval Slide Fasteners v. Molfetta, 188 N.Y. Misc. 787, 70 N.Y.S. 2d 411 (1947); Swenson v. Seattle Central Labor Council, 27 Wash. 2d 193, 177 P. 2d 873 (1947); Turner v. Zanes, 206 S.W. 2d 144 (Tex. Civ. App., 1947); Burlington Transportation Co. v. Hathaway, 234 Iowa 135, 12 N.W. 2d 167 (1943).

[46] Note 37 supra.

ing discriminatory hiring practices,[47] 5) inducing a closed-shop contract,[48] and 6) inducing a secondary boycott.[49] Clearly the courts are operating on the outer fringes of the solicitation rationale. And can it be said that the accomplishment of these "objects" constitutes a clear and present danger of substantive evil?

III

The major controversy over the right to picket centers around the categories of liberty of utterance and economic warfare. Whether unlawful objects must be tested by clear-and-present-danger techniques[50] or by legislative and judicial preference, depends largely upon which concept most successfully assimilates picketing speech. The effectiveness of picketing is based upon its appeal to class solidarity rather than upon the justice of its ends. It functions as a signal for the alignment of social forces hostile to the picketee, on grounds which are independent of any particular labor controversy. Hence, while not properly "persuasion," it is nevertheless a form of communication designed to enlist the cooperation of persons sympathetic to the interests of organized labor. But because there is no conceptual peg between the tweedledum of economic pressure and the tweedledee of "pure speech," picketing has been left to vacillate in the undefined area between the competing categories. Justice Douglas, concurring in the *Wohl* case, was able to reconcile this middle ground with the *Thornhill* decision by distinguishing the speech from the nonspeech aspects of picketing. "Picketing by an organized group is more than free speech, since it involves patrol of a particular locality and since the very presence of a picket line may induce action of one kind or another quite irrespective of the ideas which are being disseminated. Hence, those aspects of picketing make it the subject of restrictive regulation. But since 'dissemination of information concerning the facts of a labor dispute' is constitutionally protected, a State may not define 'labor dispute' so narrowly as to accomplish indirectly what it may not accomplish directly."[51]

The use of speech to further economic ends has been a sore spot to the Supreme Court upon more than one occasion. The employer free speech cases reflect one aspect of the ambivalent attitude toward economic speech. Although an

[47] Note 36 supra.

[48] Notes 27–31 supra.

[49] United Brotherhood of Carpenters & Joiners v. Sperry, 15 C.C.H. Lab. Cas. ¶64814 (C.A. 10th, 1948); Printing Union v. LeBaron, 23 L.R.R.M. 2145 (C.A. 9th, 1948); LeBus v. Pacific Coast Marine Firemen Assoc., 15 C.C.H. Lab. Cas. ¶64794 (D.C. La., 1948); Wisconsin Employment Relations Board v. Milk & Ice Cream Drivers Union, 238 Wis. 379, 299 N.W. 31 (1941), cert. den. 316 U.S. 668 (1942).

[50] The Supreme Court's stand on the clear-and-present-danger test was clearly stated in Bridges v. California, 314 U.S. 252, 263 (1941). "What finally emerges from the 'clear and present danger' cases is a working principle that the substantive evil must be extremely serious and the degree of imminence extremely high before utterances can be punished." Compare Craig v. Harney, 331 U.S. 367 (1947); Pennekamp v. Florida, 328 U.S. 331 (1946).

[51] Bakery & Pastry Drivers Local v. Wohl, 315 U.S. 769, 776 (1942). See Jaffe, In Defense of the Supreme Court's Picketing Doctrine, 41 Mich. L. Rev. 1037 (1943).

employer is free to take sides on controversial issues, his activities are "forever suspect" because of the possibilities of coercion which the context of his remarks may disclose.[52] Commercial advertising is another form of economic communication that has been placed outside the sphere of free speech guarantees.[53] Nevertheless, the Supreme Court has struck down restrictions on the "sale" of Jehovah's Witness literature, even where the seller has made his living thereby.[54] Presumably this is based on the ground that the content of the literature is not of a commercial nature. But in *Thomas v. Collins*[55] the Court swung back to the middle of the road. Justice Rutledge there announced: "The idea is not sound therefore that the First Amendment's safeguards are wholly inapplicable to business or economic activity. And it does not resolve where the line shall be drawn in a particular case merely to urge . . . that an organization for which the rights of free speech and free assembly are claimed is one 'engaged in business activities,' or that the individual who leads it in exercising these rights receives compensation for doing so."[56]

The reluctance of the courts to extend constitutional protection to commercial speech probably derives from the distinction between speech in the public interest and speech in the private interest. Since economic communication is identified with private gain, it has not generally been held entitled to constitutional protection. The *Thornhill* doctrine blurred this distinction by identifying the private interest of labor with the public interest at large. Picketing was equated with discussion concerning the conditions in industry and the causes of labor disputes, and this discussion the court deemed "indispensable to the effective and intelligent use of the processes of popular government to shape the destiny of modern industrial society."[57] In the light of this principle picketing has been permitted wider latitude than any other form of economic communication, even in the face of its obvious nonverbal characteristics.

The root of the differentiation of picketing speech from other utterances inspired by prospects of economic gain must lie in the policies which define the

[52] NLRB v. Ford Motor Co., 114 F. 2d 905 (C.C.A. 6th, 1940), cert. den. 312 U.S. 689 (1941). Compare NLRB v. Virginia Electric & Power Co., 314 U.S. 469 (1941); Schweitzer v. NLRB, 144 F. 2d 520 (App. D.C., 1944).

[53] Valentine v. Chrestensen, 316 U.S. 52, 54 (1942). See Wolff, Unfair Competition by Truthful Disparagement, 47 Yale L.J. 1304 (1938). In Lewis Publishing Co. v. Morgan, 229 U.S. 288 (1913), the Supreme Court upheld a post-office regulation denying 2d-class mailing privileges to publications "designed primarily for advertising purposes." Cf. Hannegan v. Esquire, 327 U.S. 146 (1946).

[54] Follett v. McCormick, 321 U.S. 573 (1944); Murdock v. Pennsylvania, 319 U.S. 105 (1943). Similarly, the distribution of handbills advertising religious literature could not be prohibited by city ordinance. Jamison v. Texas, 318 U.S. 413 (1943).

[55] 323 U.S. 516 (1945). In a five to four decision, the Court held unconstitutional a Texas statute requiring union organizers to get permission from the Secretary of State prior to soliciting union memberships. The Court conceded that this was economic activity.

[56] Ibid., at 531.

[57] Thornhill v. Alabama, 310 U.S. 88, 103 (1940).

lawful area of self-help in labor disputes.[58] The question remains whether any such policy justifies pegging the right on the level of a constitutional privilege. If picketing is sufficiently important, pro-picketing legislation would seem the more desirable alternative. If the requisite political power is lacking, is it the office of the judiciary to remedy the deficiency? Surely the vigorous role assumed by the legislatures in the regulation of industrial conflict militates strongly against judicial intervention.

Should the rise of the unlawful-object test be welcomed as a qualification of an unsound doctrine? If unlawful objects are subject to clear-and-present-danger techniques, a substantial part of the *Thornhill* doctrine may yet be salvaged from the *Giboney* case. But the extensive pre-*Giboney* use of the unlawful-object test indicates that such restraint will not be exercised. Continued lip-service to the *Thornhill* doctrine seems an unpardonable subterfuge if the creation of unlawful objects is governed only by judicial and legislative whimsy. The Supreme Court has argued that the *Giboney* case does not qualify *Thornhill v. Alabama*. A generous interpretation of the decision may support this contention. The critical test will come when the Court decides whether a state may outlaw the closed-shop picket or recruiting picket by employing the illegal purpose device. If such objects do not threaten a clear and present danger of substantive evil, the Supreme Court will have to elect between affirmation or repudiation of the *Thornhill* doctrine.[59] The real problem must then be faced. Are the courts or the legislatures the proper organs of labor policy?

CHURCH AND *SPIEGEL* IN PERSPECTIVE

I

In two recent companion cases dealing with the federal estate tax, *Com'r v. Estate of Church*[1] and *Estate of Spiegel v. Com'r*,[2] the members of the Supreme Court wrote six opinions reflecting the provocative treatment of the subject they belabor. The opinions—two majority, three dissenting, and one dissenting in part—reached the impressive length of 55,000 words. These opinions were

[58] See Riesman, Civil Liberties in a Period of Transition, 3 Pub. Policy 80 (1942); Meiklejohn, Free Speech and Its Relation to Self Government 63 (1948); Holmes, J., in Vegelahn v. Gunter, 167 Mass. 92, 106, 44 N.E. 1077, 1080 (1896): "The true grounds of decision are considerations of policy and of social advantage, and it is vain to suppose that solutions can be attained merely by logic and general propositions of law which nobody disputes. Propositions as to public policy rarely are unanimously accepted, and still more rarely, if ever, are capable of unanswerable proof."

[59] The Supreme Court has already granted certiorari to review a case in which picketing to induce an employer to adopt a discriminatory hiring policy was enjoined. Hughes v. Superior Court, 15 C.C.H. Lab. Cas. ¶64824 (Calif., 1948), cert. granted 69 S. Ct. 930 (1949). The impending Hughes case will be the acid test for the Thornhill doctrine. The Court's recent denial of certiorari in the less critical case of Pa. L.R.B. v. Chester and Delaware Counties Bartenders Local, 361 Pa. 246 (1949), cert. den. 69 S. Ct. 812 (1949), may indicate that the Hughes case was chosen specifically for this purpose.

[1] 335 U.S. 632 (1949). [2] 335 U.S. 701 (1949).

especially notable because the inauspicious beginning of the cases in the lower courts did not herald the expansive reception they were to receive in the Supreme Court. Not satisfied with the limited nature of the initial oral argument, the Court, envisioning a more significant role for these cases, stimulated counsel to prepare additional argument on nine questions it had propounded.[3] Fifteen months after the original hearing the long-awaited decisions were handed down.

The questions, because they related to the desirability of overruling several of the Court's established interpretations of Section 811(c) of the Internal Revenue Code,[4] raised doubts as to the present status of many of the Court's former holdings.[5] When the Court announced its results, one major precedent of nineteen years' standing[6] had been overruled. This was the second important interpretation of Section 811(c) discarded by the Court in the past ten years.[7] But the status of other holdings upon which doubt had been cast by the Court's nine questions was not explicitly resolved by the majority opinions.

The *Church* and *Spiegel* decisions immediately occasioned lengthy comments, criticisms, and proposals for legislative correction from members of the bar.[8] At least one state legislature reacted by passing an act changing the state's property law in such a manner as to circumvent the *Spiegel* decision.[9] The *Spiegel* decision appeared particularly irritating because the imposition of a tax of $450,000 turned on a highly technical point of the future interests law of Illinois.

II

The 55,000 words of the opinions were devoted to interpreting one phrase in Section 811(c) of the estate tax provisions of the Internal Revenue Code.[10] The

[3] Journal S. Ct., Oct. Term 1947, 296–98; Estate of Spiegel v. Com'r, 68 S. Ct. 1522 (1948); Com'r v. Estate of Church, 68 S. Ct. 1524 (1948).

[4] Revenue Act of 1926, § 302(c), 44 Stat. 9, 70 (1926), as amended by Revenue Act of 1932, § 803(a), 47 Stat. 169, 279 (1932), 26 U.S.C.A. § 811(c) (1947).

[5] The questions specifically related to the propriety of overruling Reinecke v. Northern Trust Co., 278 U.S. 339 (1929), and May v. Heiner, 281 U.S. 238 (1930).

[6] May v. Heiner, 281 U.S. 238 (1930).

[7] In 1940, Helvering v. Hallock, 309 U.S. 106, overruled the companion cases, Helvering v. St. Louis Union Trust Co., 296 U.S. 39 (1935), and Becker v. St. Louis Union Trust Co., 296 U.S. 48 (1935).

[8] See Conway, I.R.C. § 811(c)—The Church and Spiegel Interpretation, 34 Corn. L.Q. 376 (1949); Durbin, Estate Taxation of Inter-Vivos Trusts after Spiegel and Church, 30 Chicago Bar Record 199 (1949); Foosaner, New Estate Planning Hazard, 88 Trusts & Estates 108 (1949); Looker, Estate Taxation of Living Trusts: The Church and Spiegel Decisions, 49 Col. L. Rev. 437 (1949); Schrenk and Wellman, The Church and Spiegel Cases, 47 Mich. L. Rev. 655 (1949); Schuyler, address delivered at Chicago Bar Association section meeting (March 9, 1949); The Church and Spiegel Cases: The Meaning of a Transfer Effective at Death, 49 Col. L. Rev. 533 (1949).

[9] Minn. L. 1949, c. 201 (approved March 26, 1949).

[10] 47 Stat. 169, 279 (1932), 26 U.S.C.A. § 811(c) (1947).

particular clause of this section construed in the *Church* and *Spiegel* cases brings into the donor's gross estate at his death certain interests he has transferred during his life. The interests brought back are considered to be like testamentary dispositions in that the donees must await full enjoyment of their interests until the donor's death. Section 811(c) provides that, "The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property. . . . (c) To the extent of any interest therein of which the decedent has at any time made a transfer by trust, or otherwise . . . intended to take effect in possession or enjoyment at or after his death. . . ." It was designed to prevent evasion of the estate tax. The application of the "possession or enjoyment" clause always involves a determination of what interests transferred by a donor during his life should be brought back into his gross estate at death. In the instant cases, the Supreme Court held, on the basis of the above statutory provision, that certain interests transferred by inter vivos trust should be included in the gross estates of the decedents Spiegel and Church.

Section 811(c) also requires gifts made "in contemplation of death" to be included in decedents' gross estates; however, the only aspect of this section involved in the *Church* and *Spiegel* cases was the "possession or enjoyment" clause. Future references in this note to Section 811(c) will therefore apply only to the "possession or enjoyment" clause.

In 1924 Francois Church executed an inter vivos trust instrument, reserving the income for his life. Upon his death, which occurred in 1939, the trust was to terminate and the corpus was to be distributed among his children, or, if none were living, among his brothers and sisters.[11] The Supreme Court held that the corpus of this inter vivos trust was to be brought back into the decedent's gross estate on the basis of Section 811(c), because the children's enjoyment of their interests was suspended until the termination of the donor's life interest.

In 1920 Sydney Spiegel executed a trust instrument providing that during his life the income was to be divided among his three children, or, in the event of their deaths, among their surviving children. Upon the donor's death, the corpus was to be distributed in a like manner. Although the donor apparently attempted to dispose of his entire interest in the trust property, the Court found

[11] The settlor also retained a possibility of reverter arising by operation of law. The only point at issue in the lower courts and presented to the Supreme Court for consideration on appeal was whether this retention of a possibility of reverter required the inclusion of the corpus of the trust in the settlor's gross estate at his death. A similar point was at issue in the Spiegel case, and the Supreme Court consolidated the actions. Of its own motion, the Court requested argument on whether May v. Heiner, 281 U.S. 238 (1930), should be overruled, i.e., whether the reservation of the life estate by Mr. Church, regardless of the possibility of reverter, required the value of the corpus in the Church trust to be included in the decedent's gross estate. Since the Court held that the corpus must be included in the decedent's gross estate because the settlor retained a life estate, it was unnecessary for the Court to consider the possibility of reverter point in the Church case.

that he failed to do so because the instrument made no provision for the distribution of the corpus in the event that all of the settlor's children and grandchildren predeceased him. The Court concluded that the property would have reverted to the settlor if such an unlikely event had occurred.[12] Because the donor inadvertently retained until his death the theoretical possibility of regaining the trust property,[13] the Court held that the entire corpus of the trust should be brought back into the donor's estate at death. The value of the settlor's reversionary interest was admittedly included in the donor's gross estate under Section 811(a) and was not at issue in this case. The certainty that the children would come into enjoyment of their interest in the corpus arose only at the settlor's death, when his possibility of regaining the property ended. Therefore, the Court viewed the trust transfer as within the terms of Section 811(c).

To the beneficiaries, the bitter reality of the Court's reasoning was an additional tax of $450,000 imposed on the estate because the trust instrument had failed to specify an ultimate taker in the event a theoretically possible but highly improbable event had occurred—namely, the death of all the contingent beneficiaries before the death of the settlor. The actuarial value of the settlor's reversionary interest just prior to his death amounted to $70,[14] but the retention of this insignificant interest resulted in tax liability to the Spiegel estate of more than six thousand times the value of the interest.

The result at which the majority of the Court arrived in the *Spiegel* case is not easily foreseen from a mere perusal of the language of Section 811(c). The evident underlying purpose of the section is to bring into the decedent's gross estate those interests he has transferred in an attempt to avoid the estate tax. Apparently, as was pointed out above, the settlor in the *Spiegel* case attempted to dispose of all his interest in the trust property and had no intention of avoiding the estate tax. On the other hand, the *Church* result is more nearly in accord with the purpose of Section 811(c) because the settlor in that case, under his reserved life estate, continued to enjoy the benefits of the property until his death, at which time, the benefits passed to his children. And yet the Court's past construction of the "possession or enjoyment" clause has been such that, immediately prior to the announcement of the Court's decisions, persons familiar with the judicial history of Section 811(c) could have more easily anticipated the result in the *Spiegel* case than the result in the *Church* case.

[12] The Supreme Court accepted the finding of the Court of Appeals for the Seventh Circuit that, under controlling Illinois law, the failure of a trust through lack of beneficiaries would cause a resulting trust in favor of the settlor to arise.

[13] The phrase "possibility of reverter" is frequently used to describe the settlor's possibility of regaining the property under circumstances such as in the Spiegel case. However, it is not technically accurate to use the property label "a possibility of reverter" to characterize the settlor's interest. See 1 Tiffany, The Law of Real Property § 93 (1920). In reality, upon the failure of beneficiaries, a resulting trust in favor of the settlor arises. It has, however, become accepted phraseology to term this interest "a possibility of reverter" or a "reversionary interest."

[14] The value of the settlor's possibility of reverter in 1920, when he created the trust, was $4,000. Its value decreased with the birth of successive grandchildren.

III

A detailed recounting of the judicial mishandling of Section 811(c) has been made at length elsewhere[15] and is not necessary for an appreciation of the implications of the *Church* and *Spiegel* decisions. The tortuous history of the section can be sketched by a more general treatment of its main line of development. In two early interpretations, the Supreme Court narrowly restricted the application of the section. In 1927 it was held in *Shukert v. Allen*[16] that an inter vivos trust providing for the accumulation of income and the distribution of the corpus and accumulated income to the beneficiaries at a time when the settlor probably would be dead did not have to be included in the decedent's gross estate at his death. The Court held that an interest to come into enjoyment after the donor's death need not be included in the donor's gross estate if the donor's transfer of the interest was unaffected by whether he lived or died. In *Reinecke v. Northern Trust Co.*[17] the settlor had executed several trusts which provided, in substance, that certain beneficiaries were to receive the income until their deaths, or until five years after the donor's death, whichever event occurred first, whereupon named remaindermen were to receive the corpus. The Supreme Court held that the fact that a gift "was intended to take effect . . . at or after . . . death. . . ." was not alone sufficient to bring the trust back into the donor's estate. It required, in addition, that there must be a "passing from the possession, enjoyment or control of the donor at his death" before the trust would be included in the decedent's estate pursuant to Section 811(c). The result of the *Shukert* and *Reinecke* decisions was that the corpus of a trust which was to be distributed at or after death was not, by virtue of that fact alone, included in the decedent's gross estate, although a literal reading of Section 811(c) would suggest an opposite result.

The next significant case interpreting the section was *May v. Heiner*[18] in 1930. In this case, the decedent had executed a trust giving the income to her husband for his life, then to herself for life, and after her death to the children. A trust reserving a life estate in the donor would seem to be one most clearly required to be included in the decedent's gross estate by Section 811(c). "It is true that an ingenious mind may devise other means of avoiding an inheritance tax, but the one commonly used is a transfer with a reservation of a life estate."[19] "Our prospective decedent who keeps a life estate is anxious to enjoy as if he never gave and to avoid as if he actually gave."[20] But, despite the clear applica-

[15] For a detailed analysis of the case history of Section 811(c) see Eisenstein, Estate Taxes and the Higher Learning of the Supreme Court, 3 Tax L. Rev. 395 (1948); Paul, Federal Estate and Gift Taxation, § 7.21 et seq. (1942), 1946 Supplement § 7.21 et seq.

[16] 273 U.S. 545 (1927). [17] 278 U.S. 339 (1929). [18] 281 U.S. 238 (1930).

[19] Matter of Keeney, 194 N.Y. 281, 287, 87 N.E. 428, 429 (1909), aff'd sub nom. Keeney v. New York, 222 U.S. 525 (1912).

[20] Eisenstein, Estate Taxes and the Higher Learning of the Supreme Court, 3 Tax L. Rev. 395, 448 (1948).

bility of the section, the Supreme Court refused to hold that a trust with a reserved life estate must be included in the decedent's gross estate.

The rationale of this surprising holding, the affirmation of which by the Supreme Court a year later "came . . . like a bombshell" to Congress,[21] was derived from the *Reinecke* case. The latter case determined that a "passing from the possession, enjoyment or control of the donor" at death was a prerequisite to the inclusion in the decedent's gross estate of the interests transferred. In the *May* case, Justice McReynolds centered his attention on "passage . . . from the donor," but ignored the phrase "possession, enjoyment or control. . . ." He ruled that since "title" passed to the beneficiaries when the trust was created, their interests were fixed at that time and Section 811(c) did not require the inclusion of the transfers in the gross estate. Clearly, however, "enjoyment" of the trust income did pass to the beneficiaries at the settlor's death and a proper application of the *Reinecke* rule would have led to a different result in the *May* case.

The *May* case, though frequently criticized, was an accepted precedent prior to the decision in *Helvering v. Hallock*[22] in 1940. Although the *Hallock* case did not involve the settlor's retention of a life estate, but rather concerned the retention of a reverter by the settlor, the rationale of the decision was relevant to transfers involving retained life estates. In the *Hallock* case, the settlor created an inter vivos trust giving the income to his wife for her life. Upon the death of the wife, the principal and income were to return to the settlor, or, if he were not then living, they were to go to his children. The enjoyment of the children's interests was dependent upon the death of the grantor, and therefore their value was included in the decedent's gross estate. The Court reasoned that if a settlor makes a gift of interests contingent upon his death the transfer of such interests is akin to a testamentary disposition.[23]

The *Hallock* ruling destroyed the keystone of the *May* case rationale that complete passage of title before the settlor's death prevents the application of Section 811(c). The Court determined in the *Hallock* case that the section required the Court to ascertain realistically when the interests transferred took effect in "possession or enjoyment" rather than to ascertain legalistically when

[21] 74 Cong. Rec. 7078 (1931). [22] 309 U.S. 106 (1940).

[23] The Hallock decision overruled Helvering v. St. Louis Union Trust Co., 296 U.S. 39 (1935), and Becker v. St. Louis Union Trust Co., 296 U.S. 48 (1935). The latter cases held that if the remainder interests are vested at the time of the creation of the trust, subject to divestment in the event the donee predeceases the donor, the gift is technically vested and not contingent on the donee's survivorship. Hence, the Court held there was nothing akin to a testamentary disposition, and thereby made the imposition of the estate tax dependent upon the technical phraseology of the trust instrument. The Court had previously held in Klein v. United States, 283 U.S. 231 (1931), that if the remainder interests were contingent in form they were subject to the estate tax. In repudiating the St. Louis Union Trust Co. cases, the Court refused to recognise a distinction between gifts with a condition precedent and those with a condition subsequent. If the effect of the trust was that no remainderman could enjoy his gift except by surviving the donor, the Court held that the gift was contingent on the donor's death.

"title" passed. Mr. Justice Frankfurter colorfully observed that the "unwitty diversities" and "casuistries" of property concepts should not be determinative in taxation questions. The last chapter in the interplay of the life estate and reverter cases is the *Church* case, where the Court repudiated the *May* case on the basis of the *Hallock* decision, and thus created a more consistent body of judicial interpretation of Section 811(c).

The undermining of the *May* case as an authoritative precedent continued after the *Hallock* decision. In *Fidelity-Philadelphia Trust Co. v. Rothensies*[24] the Court's holding that certain interests should be included in the decedent's gross estate implied a repudiation of the *May* case. The donor in the *Fidelity* case had created an inter vivos trust reserving the income for life. After the donor's death his surviving daughters were to take, and after their death, the daughters' surviving descendants were to take. But if both daughters died without descendants surviving, the corpus was to go to such persons as the settlor might appoint by will. The Court held the entire corpus of the trust was to be included in the decedent's gross estate, because until his death it was uncertain whether the property would ultimately pass by the power of appointment or by the trust instrument. The Court refused to deduct the value of the daughters' life estates before computing the tax, although these interests were not subject to the power of appointment. These interests were contingent, as were those in the *May* case, only in that they followed the donor's life estate. By refusing to deduct the value of these interests, the Court repudiated the *May* case.[25]

Following the *Hallock* decision the Tax Court generally had committed itself to a policy of drawing the line between trusts containing remote reverters and those containing less remote reverters. Only the latter type of trusts were included in the gross estates of decedents.[26] The extension of the *Hallock* holding in the *Spiegel* case to remote reverters was foreshadowed by *Com'r v. Estate of Field*.[27] The significant fact in the *Field* case was the settlor's retention of a remote reverter. The case was like the *Church* case in that the settlor retained both a life estate and a possibility of reverter. By requiring the trust to be included in the decedent's gross estate as a result of the *Hallock* holding, the Court's decision indicated that the remoteness of the possibility of reverter was irrelevant. Inasmuch as the Court had not expressly considered the remoteness of the reverter in the *Field* case, it was not certain even after that case that remoteness was no longer an issue of importance.

[24] 324 U.S 108 (1945).

[25] Compare Goldstone v. United States, 325 U.S. 687, 693 n. 3 (1945). The Fidelity case was granted certiorari only to consider the valuation point; hence, the Court did not directly consider whether May v. Heiner should be overruled.

[26] See Paul, Federal Estate and Gift Taxation (Supp., 1946), § 7.23, for a full discussion of the Tax Court's application of Helvering v. Hallock.

[27] 324 U.S. 108 (1945). The settlor created an inter vivos trust reserving the income for life. The trust was to endure for the lives of two of the settlor's nieces. If both nieces died before the settlor, the corpus was to be paid over to him rather than to beneficiaries named in the trust.

The *Spiegel* case explicitly stated that remoteness of a reverter is irrelevant.[28] And, in addition, the *Spiegel* decision resolved another problem raised by the *Hallock* case. It was uncertain after the *Hallock* decision whether its holding applied to trusts containing reversions not expressly retained but arising by operation of law.[29] The *Spiegel* case held that trusts with reverters arising by operation of law were to be included in the decedent's gross estate.

The Treasury Regulations following the *Hallock* and *Fidelity* cases[30] summed up the status of Section 811(c) by stating that an inter vivos transfer would be included in the decedent's gross estate if (1) the possession or enjoyment of the transferred interest could be obtained only by beneficiaries who must survive the decedent and (2) the decedent or his estate possessed some right or interest in the property other than a life estate. The Bureau has proposed to bring the Regulations into conformity with the *Church* decision by striking from the second condition the clause "other than a life estate."[31] No change in the Regulations is proposed as a result of the *Spiegel* decision.

IV

The conflicting and lengthy Supreme Court opinions in the *Church* and *Spiegel* cases, and the excitement they engendered, especially the vigorous reaction of the tax bar, obscure the relatively limited scope of the cases. The application of the *Church* holding is limited to trusts executed before 1931. In that year the possibilities created by the *May* case for wholesale estate tax evasion were hastily checked by Congress. After the Supreme Court affirmed the *May* case in three per curiam decisions,[32] a Joint Resolution[33] was passed requiring trusts reserving life estates to be included in the donor's gross estate. The Resolution was later judicially construed to have only a prospective application;[34] thus, trusts created before 1931 reserving life estates were protected from the estate tax by the rule in the *May* case. By overruling the *May* case, the *Church* case requires these early trusts to be included in the decedent's estate. These early trusts can be viewed as falling into two different groups—those trusts created by settlors now deceased whose estate tax liability under Section 811(c) has not yet been finally determined, and those trusts created by settlors who have not

[28] If a gift is taxed because it is contingent upon the donor's death, the remoteness of the likelihood that the gift will revert to the donor has no logical significance. The gift is equally contingent whether the reverter is or is not remote.

[29] A reverter arising by operation of law is one created by law when the settlor has failed to dispose of his complete interest in the trust property.

[30] Reg. 105, § 81.17 (1942), as amended by T.D. 5512 (1946).

[31] Proposed Amendments to § 81.17, 81.18 of Estate Tax Regulations, Bureau of Internal Revenue, Treasury Department (April 15, 1949).

[32] Burnet v. Northern Trust Company, 283 U.S. 782 (1931); Morsman v. Burnet, 283 U.S. 783 (1931); McCormick v. Burnet, 283 U.S. 784 (1931).

[33] 46 Stat. 1516–17 (1931), 26 U.S.C.A. § 811(c) (1947).

[34] Hassett v. Welch, 303 U.S. 303 (1938).

yet died. The former group are protected from tax consequences under Section 811(c) by the proposed amendments to the Treasury Regulations limiting the application of the *Church* decision to the estates of settlors who have died or will die after January 17, 1949, the date of the *Church* decision.[35] Because relatively few settlors are still living who created trusts reserving life estates before 1931, the limited application of the *Church* case is apparent.

The *Spiegel* decision added little to past interpretations of Section 811(c) and raised few problems for the future. The sophisticated among the tax bar were forewarned of the eventuality of the *Spiegel* result even before the *Hallock* case. The decision in *Klein v. United States*[36] in 1931 made apparent that trusts with possibilities of reverter expressly retained by settlors might be brought back into their gross estate at death. The *Hallock* case emphasized the dangers of such retention. Probably few trust instruments containing possibilities of reverter were executed by cautious draftsmen after these decisions. Also, the *Fidelity* case signaled the tax bar that trusts with remote reverters arising by operation of law would likely also be encompassed by the *Hallock* ruling.[37]

The heavy tax consequences of the *Spiegel* decision will be felt by one small group of estates. Although past decisions warned of the impending *Spiegel* holding, the Tax Court did not require trusts with remote reverters arising by operation of law to be included in decedents' gross estates before the *Spiegel* decision. The *Spiegel* decision, then, is limited to the estates of settlors still living or to the estates of settlors who have died but whose estate tax consequences have not been determined. But settlors who are still living can probably avoid the *Spiegel* result by conveying any possible interest they may have retained to a charity or to the United States Government, and future settlors can accomplish a like result by including a similar clause in the trust instrument. Thus, the remaining group of estates presently vulnerable to the drastic tax result of the *Spiegel* decision are those few estates now in the process of having their estate tax liability determined.

Certain minor practical problems are left in the wake of the *Spiegel* decision. As pointed out above, settlors of Spiegel-type trusts who are still living may attempt to avoid the inclusion of the trusts in their gross estates at death by conveying to a charity any interest they retain. The Commissioner might argue that conveyances by settlors of remote possibilities of reverter were "in contemplation of death,"[38] since the motive was avoidance of the estate tax. However,

[35] Proposed Amendments to § 81.17, 81.18 of Estate Tax Regulations, Bureau of Internal Revenue, Treasury Department (April 15, 1949). The Proposed Regulations also made changes in the examples as a result of the Church decision. Example 6 was struck out in its entirety and a new example inserted in lieu of it.

[36] 283 U.S. 231 (1931). See note 23 supra.

[37] Paul, Federal Estate and Gift Taxation (Supp., 1946), § 7.21 et seq.

[38] United States v. Wells, 283 U.S. 102, 117 (1931): A gift is in contemplation of death if the motive which induces it is of the sort which leads to testamentary disposition.

in view of *Allen v. Trust Co. of Georgia*,[39] such an argument would probably not be upheld. In 1935, the Supreme Court held that trusts reserving to the settlor the power to amend with the consent of the trustees and beneficiaries must be included in the settlor's gross estate at death.[40] The settlor in the *Allen* case, who was a lawyer, immediately thereafter renounced his power to amend a trust he had executed in 1924. The Court held that the renunciation was not in contemplation of death and the trust did not therefore need to be included in the decedent's gross estate. The rationale of the decision was that if the release by the settlor was to carry out his original trust plan, it would not be considered in contemplation of death. If the Court follows the *Allen* decision in the analogous situation of a conveyance by a settlor of any possible interest he may retain, the trust would not be included in the decedent's gross estate at death.[41]

Settlors who have created trusts such as that in the *Church* case will not be as willing to convey away their life estates simply to avoid the result of that decision, since it is likely that these trusts were created by settlors with the intention of depending upon the income from them during life.

A possible means of circumventing the *Spiegel* decision is suggested by a recent Minnesota statute.[42] The statute provides that in all trusts where a reversionary interest in the settlor would arise by operation of law, a resulting trust in favor of the state shall henceforth be deemed to arise. The statute applies both to trusts created in the past and to those to be created in the future. By destroying a settlor's possibility of reverter, the Minnesota statute makes ineffectual the result of the *Spiegel* decision on Minnesota residents inasmuch as the federal courts follow state property law.[43]

V

The minor practical problems presented by the *Church* and *Spiegel* decisions do not explain the unusual interest they have aroused. Perhaps a good deal of the interest may be explained by the departure from precedent in the *Church* case. The overruling of a statutory interpretation of so many years' standing was disconcerting, although, as pointed out, the *May* case had been universally

[39] 326 U.S. 163 (1946).

[40] Helvering v. City Bank Farmers Trust Co., 296 U.S. 85 (1935).

[41] A possible means of avoiding the "contemplation of death" problem would be to sell the possibility of reverter for its exact actuarial value. It has been contended that the settlor's possibility of reverter cannot be conveyed because of the common-law rule that a possibility of reverter was not assignable. Schuyler, Property Law Still Has Tax Consequences, 29 Chicago Bar Record 248, 29 Chicago Bar Record 297, 308 (1948). However, strict adherence to the common-law property rule does not seem appropriate in these cases since the settlor's interests are resulting trusts rather than true "possibilities of reverter."

[42] Minn. L. 1949, c. 201 (approved March 26, 1949).

[43] Another possibility for legislative correction of the Spiegel result would be a congressional act providing that only the actuarial value of the possibility of reverter should be included in the decedent's gross estate if the reverter is remote and arises by operation of law. A bill so providing was introduced in the 80th Congress. H. Res. 6712, § 202 (May 26, 1948). It died in the House when Congress adjourned for the summer.

condemned as an erroneous interpretation and the *Hallock* case had destroyed its basic premise.[44] The overruling of the *May* case was especially surprising because it was uninvited: the contention that it should be discarded had not been raised by the parties in the lower courts and was not argued by counsel until the Supreme Court asked for argument on rehearing.

A more personal source of annoyance to the practitioner was the upsetting effect of the *Spiegel* decision on trust plans already created. Experienced members of the bar who had carefully drafted trust instruments for wealthy clients in the 1920's or earlier could not have been expected to foresee the tortured history of Section 811(c) culminating in the *Spiegel* decision. Yet the enormous added taxes levied on particular estates as a result of this understandable failure to foresee are none the less discomfiting. The beneficiaries of the *Spiegel* trust were deprived of one-half the corpus by the $450,000 increased tax resulting from the settlor's inadvertent retention of a negligible interest. The fact that relatively few estates may be affected is small consolation to the clients and law firms who are hit.

Although the attorneys who had drafted these estate plans were forewarned of the probability of the *Spiegel* decision by the *Hallock*, *Fidelity*, and *Field* cases, as a practical matter there was generally little they could do to avoid the impending effect on their clients. Lawyers were reluctant even after these decisions to suggest revision of carefully planned trust arrangements merely on the basis of conjecture, especially since the reverter interests usually were of minute value. In addition, the attorneys' doubts were quieted by the Treasury Regulations following the *Fidelity* decision. The destruction of this feeling of security by the *Church* and *Spiegel* cases was not accepted with equanimity.

An aspect of the *Spiegel* decision which aroused speculation was the Court's holding that all of the interests created by the inter vivos trust should be brought back into the decedent's gross estate. The entire corpus at the settlor's death, amounting to $1,140,000, rather than the corpus minus the value of a part of the children's interest, was brought back into the gross estate, although this issue was not argued by counsel and was not discussed in any of the opinions. The inclusion of these interests in the *Spiegel* estate appears to be inconsistent, from one point of view, with the procedure suggested by the *Hallock* case.[45] In the Hallock trust, the donor gave his wife an immediate life estate.[46]

[44] Overruling former statutory interpretations is a violation of an important canon of stare decisis. Once the Court has determined the meaning of a statute, subsequent changes in the determination of that meaning are, in effect, legislation. However, the Supreme Court has previously violated this division of duties between the legislative and judicial bodies. Com'r v. Church is another example of such judicial misconduct. See Levi, An Introduction to Legal Reasoning, 15 Univ. Chi. L. Rev. 501, 519 (1948), for a complete discussion of statutory construction and the judicial process.

[45] Everett, Valuation of a "Possibility of Reverter" under the Hallock Case, 18 Taxes 611 (1940), explains the valuation procedure of the Hallock case.

[46] Upon the wife's death, the corpus was to go to the donor's children, or, if he were still living, it was to revert to him. The possibility of reverter caused the trust to be taxed under Section 811(c).

Since the donor's death had no effect upon the enjoyment of this interest, the value of the wife's life estate was not brought back into the decedent's gross estate.[47] The Spiegel trust differs from the Hallock trust in that the beneficiaries' income interests in the Spiegel trust were measured by the settlor's life. However, these beneficiaries were also the contingent remaindermen who received the corpus upon surviving the settlor. The effect of the trust was therefore to give Spiegel's three children, at the very least, income interests for their lives. Either the children would predecease the donor, in which case they would have had life interests, or they would survive the donor, in which case they would then have received, in addition, the entire corpus. In either event, interests equivalent to life estates were conferred upon them by the trust instrument and the donor's death could have no effect on these interests.[48]

Much of the interest shown in the *Spiegel* decision probably resulted from a belief that its scope might be extended beyond the particular facts at issue in the case. Comments on the *Spiegel* case[49] have suggested that the decision holds that any trust in which the settlor retains a possibility of reverter is now subject to the estate tax under Section 811(c), regardless of whether the contingency attached to the remainders is associated with the donor's death.[50] Certain dicta in Justice Black's majority opinions in the *Church* and *Spiegel* cases justify this broad application.[51] The actual holding of the case, however, is that an interest transferred by trust must be included in the decedent's gross estate if the settlor's retention of a possibility of reverter is such that the transferred interest

[47] The Supreme Court opinion in the Hallock case did not determine the measure of the tax but decided only that the estate tax should be imposed. Upon a return of the case to the Board of Tax Appeals, the Commissioner made a recomputation of the tax due, holding that the actuarial value of the wife's life estate should be deducted from the corpus of the trust before the tax was computed.

[48] See Fidelity-Philadelphia Trust Co. v. Rothensies, 324 U.S. 108, 111 (1945), where the Court stated, "The taxable gross estate . . . must include those property interests the ultimate possession or enjoyment of which is held in suspense until the moment of the grantor's death or thereafter."

[49] See Conway, I.R.C. § 811(c)—The Church and Spiegel Interpretation, 34 Corn. L. Q. 376, 390 (1949); Foosaner, New Estate Planning Hazard, 88 Trusts & Estates, 108, 109 (1949); Schrenk and Wellman, The Church and Spiegel Cases, 47 Mich. L. Rev. 655, 673 (1949).

[50] Carefully drafted trust instruments generally provide for the contingency of the death of named beneficiaries by listing several alternate takers. It is always theoretically possible that all the takers might die before the time their interests come into enjoyment. Because of this theoretical likelihood, the settlor or his estate in nearly every trust retains a possibility of reverter.

[51] Estate of Spiegel v. Com'r, 335 U.S. 701, 705 (1949). In the Church case, Justice Black said, "[A]n estate tax cannot be avoided by any trust transfer except by a bona fide transfer in which the settlor, absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property. After such a transfer has been made, the settlor must be left with no present legal title in the property, no possible reversionary interest in that title, and no right to possess or to enjoy the property then or thereafter." Com'r v. Estate of Church, 335 U.S. 632, 645 (1949).

is in any way contingent upon the settlor's death. The contingency of the transfer upon the donor's death rather than the retention of a reversionary interest appears to be the decisive factor.

At the root of the bar's concern over the *Spiegel* decision might have been the possibility that the Treasury Regulations would be changed to conform to this dicta rather than to the more limited holding of the case. The Bureau's announcement that no changes in the Regulations would be made as a result of the *Spiegel* case relieved, at least for the time being, the uneasiness of the bar that all trusts containing reverters would henceforth be included in decedents' gross estates.[52] The first condition of taxability laid down in the Regulations following the *Hallock* and *Fidelity* cases is still in effect—namely, that it must be necessary for the donees to survive the donor in order to take.[53] Had the Regulations followed the dicta, this condition would have been discarded. The Bureau's reluctance to incorporate Justice Black's sweeping language into the Regulations may well have been influenced by the excitement of the bar, and the probability of legislative nullification had it done so.

Little criticism can properly be directed at the Court's statutory interpretation in the *Church* case, despite its departure from precedent, or at the reasonable extension of the *Hallock* doctrine made in the *Spiegel* case. Underlying the manifestations of interest in the two cases is, perhaps, in addition to an appreciation of their significance as statutory interpretations, a concern over the greater impact of the estate tax resulting from judicial decision. Although at present the estate tax touches "only about 1% of those who die in adult age,"[54] it has been said that the effect of the tax upon large estates "is so heavy that it amounts to a confiscatory capital levy."[55]

As a source of revenue to the Government the estate tax is negligible, but it is of major importance as an aspect of a social policy designed to limit large accumulations of wealth.[56] The development of this social policy is dramatically illustrated by two cases—the early case of *May v. Heiner*, where the most obvious device for circumventing an estate tax was excluded from the terms of Section 811(c), and the recent case of *Estate of Spiegel v. Com'r* where a trust trans-

[52] Proposed Amendments to § 81.17, 81.18 of Estate Tax Regulations, Bureau of Internal Revenue, Treasury Department (April 15, 1949).

[53] Reg. 105, § 81.17 (1942), as amended by T.D. 5512 (1946).

[54] Paul, Taxation for Prosperity 308 (1947), as quoted in Eisenstein, Estate Taxes and the Higher Learning of the Supreme Court, 3 Tax L. Rev. 395 (1948).

[55] Lowndes, Tax Avoidance and the Federal Estate Tax, 7 Law & Contemp. Prob. 309, 328 (1940).

[56] "It [federal estate tax] is aimed directly at the destruction of large accumulations of property. Taken in conjunction with current federal spending policies and the federal income and gift taxes, the federal estate tax is part of a deliberate plan to redistribute both the capital and income of the nation." Ibid., at 328.

fer which could not in any sense be considered as an attempt to circumvent the estate tax was included within the terms of the section. Opponents of this social policy may well be concerned over the change in judicial attitude from the days of *May v. Heiner*, when a technical property doctrine was employed to frustrate Section 811(c), to the days of *Estate of Spiegel v. Com'r*, when a technical property doctrine was employed to give the section its full scope.

RECENT CASES

INCOME TAX CONSEQUENCES OF CANCELLATION OF INDEBTEDNESS

The problem of the income tax consequences of the cancellation or reduction of indebtedness has recently been given another partial answer in the Supreme Court's decision in *Com'r v. Jacobson*.[1] There the taxpayer, who was solvent though in financial difficulties, purchased his own bonds at a discount from his creditors.[2] The Court held that there was a taxable gain to the extent of the difference between the face value of the bonds and the amount for which the taxpayer purchased them.

In the *Jacobson* case, as in all the cancellation of indebtedness cases, the initial question is whether the cancellation results in income to the debtor. Assuming an affirmative answer, the question shifts to whether that income may be excluded from the debtor's taxable gross income. The Internal Revenue Code does not offer an explicit answer to either question. Section 22(a)[3] defines gross income in extremely general terms. The exclusions from gross income authorized by Section 22(b),[4] with one rather narrow exception,[5] are not expressly applicable to gains of this type.

As a result of this lack of specific coverage by the Code, the courts have been left to determine in what situations the gain arising from a cancellation of indebtedness constitutes taxable income. The basic doctrine was established in *U.S. v. Kirby Lumber Co.*[6] where the Supreme Court held that a solvent corporate taxpayer realized taxable income by the open-market purchase at a discount of its own bonds originally issued at par.[7] The rationale of the case was,

[1] 69 S. Ct. 358 (1949).

[2] Some of the bonds were purchased by the taxpayer himself, some by his agents, and some through a bondholders' committee. The Court found that in effect all the bonds had been purchased in direct dealings between the taxpayer and the bondholders, all of whom knew that the bonds were being purchased for the taxpayer.

[3] 53 Stat. 9 (1939), 26 U.S.C.A. § 22(a) (1948); cf. Reg. 111, § 29.22(a)–13 (1943).

[4] 53 Stat. 10 (1939), 26 U.S.C.A. § 22(b) (1948).

[5] See 53 Stat. 875 (1939), 26 U.S.C.A. §§ 22(b)(9), 113(b)(3) (1948).

[6] 284 U.S. 1 (1931); cf. Old Colony Trust Co. v. Com'r, 279 U.S. 716 (1929); U.S. v. Boston & Maine R. Co., 279 U.S. 732 (1929).

[7] A similar decision was reached in Helvering v. American Chicle Co., 291 U.S. 426 (1934), in which the taxpayer, having assumed the bonded indebtedness of a company it purchased, bought the bonds at a discount. However, "the obligation to be retired must be one which unconditionally subjects the obligor's assets to liability for the payment of a fixed amount." Corp. De Ventas, etc. v. Com'r, 130 F. 2d 141, 143 (C.C.A. 2d, 1942). Where nothing of value was ever received in return for the obligations, the bonds having been issued as a divi-

"As a result of its dealings it [the debtor] made available . . . assets previously offset by the obligation of bonds now extinct."[8]

The imposition of a tax on the basis of the *Kirby* doctrine may be rather harsh in some circumstances. In all of the reduction or cancellation[9] of indebtedness cases the debtor's gain is a decrease of liabilities rather than an increase in assets. Cancellation is likely to occur either when interest rates have increased and the debtor is able to purchase his own obligations at a discount, or when a debtor, because of his straitened financial circumstances, is hard put to meet his obligations as they fall due and is able to make some arrangement with his creditors. Cases along the lines of the *Kirby* situation are frequently representative of the former type of cancellation. The courts began to develop two satellite concepts which seemed to mitigate the harshness of the *Kirby* doctrine in the latter type of cancellation, where its application likely would be especially burdensome to the debtor. These two satellites were the reduction-in-purchase-price and insolvency rules.

The reduction-in-purchase-price concept was applied where the debt was originally incurred in conjunction with the purchase of property which, at the time of the cancellation, had declined in value to an amount less than the face amount of the purchase obligation.[10] Under these circumstances, the debtor was not viewed as having received income.[11] The fact that the value of the property

---

dend to stockholders, no income arises from the purchase of the bonds at a discount. Com'r v. Rail Joint Co., 61 F. 2d 751 (C.C.A. 2d, 1932). It has been held that the cancellation by stockholders of debts owed them by the corporation did not result in taxable income, but were contributions to capital. Carroll-McCreary Co. v. Com'r, 124 F. 2d 303 (C.C.A. 2d, 1941). A discussion of the circumstances under which the debtor's purchase of its obligations results in a cancellation and receipt of income may be found in Com'r v. Pittsburg & W.V. Ry. Co., 172 F. 2d 1010 (C.C.A. 3d, 1949).

[8] U.S. v. Kirby Lumber Co., 284 U.S. 1, 3 (1931); cf. Reg. 111, § 29.22(a)–17–1(c) (1943).

[9] Throughout this note, the term "cancellation" refers to both cancellation and reduction of indebtedness.

[10] In Hirsch v. Com'r, 115 F. 2d 656 (C.C.A. 7th, 1940), the petitioner had purchased real estate for $29,000 in 1928, paying $10,000 in cash and assuming mortgage indebtedness of $19,000. In 1936 the balance due was $15,000. At that time the property had declined in value to $8,000, and the mortgagee accepted that amount in full settlement of the mortgage debt. Compare Ralph W. Gwinn, T. C. Memo., Doc. No. 108144, 3 T. C. M. 548 (1944); Mark W. Allen & Co., T. C. Memo., Doc. No. 111343, 1 T. C. M. 887 (1943); Tarleau, Federal Income Tax Considerations Applicable to Cancellation of Indebtedness, 5th Annual N.Y.U. Inst. on Fed. Taxation 664, 668 (1947). See cases decided before the early reduction-in-purchase-price cases cited in note 11 infra: Com'r v. Coastwise Transportation Corp., 71 F. 2d 104 (C.C.A. 1st, 1934), cert. den. 293 U.S. 595 (1934); L. D. Coddon & Bros., Inc., 37 B. T. A. 393, 396 (1938). But see Des Moines Improvement Co., 7 B. T. A. 279 (1927). In Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926), the amount of money lost was greater than the difference between the amount of money borrowed and the amount paid in settlement of the debt.

[11] Helvering v. A. L. Killian Co., 128 F. 2d 433 (C.C.A. 8th, 1942); Hirsch v. Com'r, 115 F. 2d 656 (C.C.A. 7th, 1940); Hextell v. Huston, 28 F. Supp. 521 (Iowa, 1939). There is a tendency to restrict the application of the reduction-in-purchase-price doctrine to cases in which the cancellation transaction actually directly relates to the original purchase price and

had so declined was some indication that the debtor might be in difficult financial circumstances. Moreover, the courts imposed the additional requirement that the cancellation be brought about in direct dealings with the creditor. This also tended to associate the reduction-in-purchase-price doctrine with situations in which the debtor was in weak financial condition rather than with those situations where there had been a decline in the market value of securities for other reasons. The application of the *Kirby* doctrine in the former situation would operate to deprive the debtor of some of the advantage gained by the cancellation and to that extent to restore him to a precarious financial position.

The reduction-in-purchase-price doctrine met with criticism on the ground that it is, in effect, a means of taking an unrealized capital loss on the property into consideration in determining whether there is taxable income when indebtedness is cancelled.[12] It was observed that the decline in value requirement allowed the gain arising from the application of the *Kirby* rule to be offset by unrealized losses on property if those losses were greater than the gain.[13] This authorization is an unusual, indirect exception to the general doctrine that

---

the debt cancelled is a purchase money obligation. See Fifth Ave.-Fourteenth St. Corp. v. Com'r, 147 F. 2d 453 (C.C.A. 2d, 1945); 54 Harv. L. Rev. 1071 (1941), noting Hirsch v. Com'r, supra. But see Des Moines Improvement Co., 7 B. T. A. 279 (1927) (decided before the Kirby case).

[12] See Surrey, The Revenue Act of 1939 and the Income Tax Treatment of Cancellation of Indebtedness, 49 Yale L.J. 1153 (1940); Darrell, Discharge of Indebtedness and the Federal Income Tax, 53 Harv. L. Rev. 977 (1940). But see 2 Mertens, Law of Federal Income Taxation § 11.20 (1942).

[13] The reduction-in-purchase-price doctrine seems to be based on Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926). There money had been borrowed in Germany, repayable in marks, by the taxpayer for its wholly owned subsidiary which lost the money in the performance of construction contracts. The obligation was later satisfied by payment of an amount substantially smaller than that borrowed, the value of the mark having fallen. The Court held that the taxpayer thereby did not realise taxable income, calling the transaction in which the obligation was satisfied a mere diminution of loss. Until the Kirby case, the Kerbaugh-Empire decision was thought to stand for the proposition that the satisfaction of a debt by payment of less than its face amount did not result in taxable gain. See Indianapolis St. Ry. Co., 7 B. T. A. 397, 399 (1927). Because of its highly questionable identification of two analytically separate transactions—the loss of the money borrowed by the subsidiary, a separate tax entity, and the subsequent satisfaction of the debt—and because of the case's conflict with the doctrine of the periodic nature of the tax, the Kerbaugh-Empire case was heavily criticized and is of doubtful validity as a precedent. However, it has never been overruled, the Kirby case merely distinguishing it on the ground that it was shown that the taxpayer there had suffered a loss while in the Kirby case the final nature of the dealings had not been revealed. Compare Helvering v. American Chicle Co., 291 U.S. 426 (1934). In any event, the idea of "looking at the transaction as a whole" to determine gain or loss, upon which is based the reduction-in-purchase-price doctrine, stems from the Kerbaugh-Empire case. For discussion of that case and the entire field of debt cancellation see the material cited in note 12 supra, and Tarleau, Federal Income Tax Considerations Applicable to Cancellation of Indebtedness, 5th Annual N.Y.U. Inst. on Fed. Taxation 664 (1947); Lynch, Some Tax Effects of Cancellation of Indebtedness, 13 Fordham L. Rev. 145 (1944); Warren and Sugarman, Cancellation of Indebtedness and Its Tax Consequences, 40 Col. L. Rev. 1326 (1940).

neither loss nor gain is recognized except in the year in which it is actually realized; generally, loss is not realized until final disposition.

If the reduction-in-purchase-price doctrine is to be used as a method of taking unrealized loss on property into consideration, it could logically be applied to all cancellation of indebtedness cases in which the value of the property has declined, even where it is worth more than the face amount of the obligation. Thus the tax would be levied on the difference between the amount of freed assets (the amount of freed assets is the difference between the face amount of the obligation and the amount paid in its satisfaction) and the amount of the decline in the value of the property.

Although it may be difficult to defend the indirect recognition of an unrealized loss in circumstances in which the property has declined in value, there is some reason for continuing to restrict the application of the reduction-in-purchase-price doctrine to cases in which the property at the time of the cancellation is worth less than the face amount of the obligation. It is only in that situation that the term "reduction in purchase price" is at all realistically descriptive of the transaction. The creditor most likely would not be able to collect the full amount of the debt by foreclosing on the property, and by asserting his claim for the balance of the obligation he might force the debtor into insolvency proceedings. In that situation it is probable that the creditor would agree to a readjustment of the contract price. The restriction of the application of the reduction-in-purchase-price doctrine to these situations may be an indication that the courts were largely concerned with aiding debtors in extreme financial straits rather than all debtors who have had a cancellation of indebtedness and whose property had declined in value. Once the property value had been determined, this restriction provided a simple, objective standard for ascertaining those cases in which the *Kirby* rule would work the greatest hardship.

A full understanding of the reduction-in-purchase-price doctrine as a limitation on the *Kirby* rule cannot be achieved without consideration of the tax benefit rule. The application of that rule to some cancellation of indebtedness cases has resulted in the imposition of a tax where the reduction-in-purchase-price doctrine would otherwise seem applicable. This rule, which is now in part embodied in the Code,[14] was developed by the courts in situations exemplified by a case in which the taxpayer receives payment of a debt that has previously been deducted from income as worthless.[15] The amount so received is charged to income in the year of receipt, not because gain is received in this taxable year but because a deduction in a previous year has proved to have been too large. The

[14] 56 Stat. 812 (1942), 26 U.S.C.A. § 22(b)(12) (1948), provides that the recovery during the taxable year of bad debts, etc., may be excluded from gross income of that year only to the extent to which the bad debt did not result in a reduction of tax in the year in which it was accrued.

[15] See Com'r v. Liberty Bank & Trust Co., 59 F. 2d 320 (C.C.A. 6th, 1932) (amounts received by taxpayer in payment of debts previously deducted from income as worthless are chargeable to income for the years in which received).

tax benefit rule is applied to cancellation of indebtedness cases where the original cost of the good or service received in exchange for the obligation has been taken as a deduction from income in the year of purchase. The taxpayer received a tax benefit by virtue of the deduction of the full purchase price. When the cancellation occurs it appears that this benefit was excessive; the amount deducted from income was larger than the amount ultimately paid. The tax benefit rule, as applied here by the courts,[16] adjusts for this by requiring that the difference between the face amount of the debt and the amount paid in its satisfaction be treated as if it were income in the year of cancellation.[17] The Code itself does not make the rule applicable to the cancellation of indebtedness cases.

Because it operates only to correct what has turned out to be an error in a previous year, the tax benefit rule has been subjected to the criticism that it is contrary to the doctrine that the tax is assessed "on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period. . . ."[18] In those cancellation of indebtedness cases in which the cancellation occurs as a result of negotiations concerning only the indebtedness, there is an identification of transactions which occur over a series of years. The identification of the transaction in which the debt was originally incurred and the transaction in which it is cancelled is unusual under the income tax which ordinarily considers the transactions of a single year.

An alternative explanation of the result that follows from the traditional application of the tax benefit rule to the cancellation of indebtedness cases, and that is not subject to the same criticism, suggests itself. It was noted that the reduction-in-purchase-price doctrine requires that the purchased property must have declined in value. Because there has been a tax benefit through the deduction from income of the original purchase price, decline in value cannot be recognized and the reduction-in-purchase-price doctrine is not applied.[19] If that doctrine is inapplicable, the rule of the *Kirby* case compels the conclusion that income is actually received in the year of the cancellation because of the "free-

[16] In Helvering v. American Dental Co., 318 U.S. 322 (1943), the Court partially relied on the reduction-in-purchase-price analogy although the cancelled debt was for back rent and accrued interest, both of which had been taken as deductions in the years in which they accrued. The reliance on that doctrine there seems unjustifiable. The Court was able to find other grounds for its decision that the cancellation of those obligations did not result in taxable income.

[17] B. F. Avery & Sons, Inc., 26 B. T. A. 1393, 1400 (1932); Helvering v. Jane Holding Corp., 109 F. 2d 933, 939 (C.C.A. 8th, 1940). On this basis the tax benefit rule would seem applicable whenever the reduction-in-purchase-price doctrine is applied to cases involving depreciable property. In those cases the taxpayer gets an excessive tax benefit from depreciation deductions based on the original purchase price. See 54 Harv. L. Rev. 1071 (1941), noting Hirsch v. Com'r, 115 F. 2d 656 (C.C.A. 7th, 1940). Consistency requires that income should be recognized to the extent of the excessive depreciation deductions. This logical result has not been attained.

[18] Burnet v. Sanford & Brooks Co., 282 U.S. 359, 363 (1931).

[19] A narrower variation of the tax benefit rule operates here to prevent the recognition of a decline in the value of the property.

ing" of the debtor's assets that results. This explanation has not been articulated in the opinions.[20]

In the *Jacobson* case the Court found that the gain was income within Section 22(a), applying the freeing of assets doctrine of the *Kirby* case.[21] The reduction-in-purchase-price concept was not applied, since the transactions did not involve purchase money obligations and because it was not shown that the debt had been incurred in the purchase of property or that the property purchased with the borrowed money had declined in value.

The second set of satellite rules which mitigates the harshness of the *Kirby* rule comes into play if the debtor was insolvent at the time of the cancellation. Under these rules the purchase and retirement of outstanding obligations for less than face value will not result in income to the debtor if he is insolvent even after the cancellation.[22] Although assets may be freed from one liability, they continue to be unavailable to the debtor, since they are offset by other obligations. The tax benefit rule does not prevent the application of the insolvency rule as it does the reduction-in-purchase-price rule.[23] Where the debtor is insolvent before the cancellation and solvent immediately after, the *Kirby* and insolvency rules meet. The two have been reconciled by a compromise which results in the holding that income is received to the extent that assets are freed from the claims of creditors.[24] Since the debtor in the *Jacobson* case was solvent, these rules were not applicable there.

[20] "The controlling decisions establish that when such items of income are so entered as accrued debt by a solvent taxpayer returning on the accrual basis, the items are deemed in law to be restored to income if and when the debt is subsequently forgiven." B. F. Avery & Sons, Inc., 26 B. T. A. 1393, 1400 (1932); cf. Helvering v. Jane Holding Corp., 109 F. 2d 933, 939 (C.C.A. 8th, 1940).

[21] In demonstrating that the gain constituted income, the Court used an argument based on a 1939 amendment to Section 22(b). This amendment, 53 Stat. 875 (1939), 26 U.S.C.A. § 22(b)(9) (1948), excludes from the gross income of corporations the amount of any income attributable to the discharge of any indebtedness of the taxpayer evidenced by a security if the appropriate regulations are complied with. See Reg. 111, § 29.22(b)(9)–1,–2; § 29.113 (b)(3)–1,–2 (1943). The amount so excluded must be applied in the reduction of the basis of any of the taxpayer's property in accordance with the provisions of an amendment to 53 Stat. 875 (1939), 26 U.S.C.A. § 113(b)(3) (1948). The Court reasoned that unless the gains derived by debtor corporations were income before the adoption of the amendments, there was no need for their passage. And since Section 22(a) does not distinguish between natural persons and corporations, gains accruing to the former must have remained taxable after the passage of the amendments. Com'r v. Jacobson, 69 S. Ct. 358, 366 (1949). Justice Frankfurter, dissenting in Helvering v. American Dental Co., 318 U.S. 322, 331 (1943), made a similar point.

[22] Main Properties, Inc., 4 T. C. 364 (1944); Kramon Development Co., 3 T. C. 342 (1944); What Constitutes Income and Loss, 47 Harv. L. Rev. 1258, 1259 (1934).

[23] See Haden Co. v. Com'r, 118 F. 2d 285 (C.C.A. 5th, 1941), cert. den. 314 U.S. 622 (1941). In Fifth Ave.-Fourteenth St. Corp. v. Com'r, 147 F. 2d 453, 457 (C.C.A. 2d, 1945) the court of appeals said: "If the insolvent taxpayer 'buys in' its debts, or any of them, for an amount equal to or greater than the amount which would have been paid to creditors upon the taxpayer's liquidation, then there is no realized taxable gain; where, however, the taxpayer 'buys in' its debts for less than such an amount, then, to that extent there is realized taxable gain." The other cases cited do not support this view.

[24] Lakeland Grocery Co., 36 B. T. A. 289 (1937); cf. the earlier decisions in Dallas Transfer & Terminal Warehouse Co. v. Com'r, 70 F. 2d 95 (C.C.A. 5th, 1934); E. B. Higley & Co.,

Once it is determined that the gain arising from the cancellation of indebtedness is income, the question arises whether that income falls within any of the exclusions from gross income in Section 22(b) of the Code. In *Helvering v. American Dental Co.*[25] the Supreme Court decided that such income might be classed as a gift within the meaning of Section 22(b)(3).[26] In that case the solvent taxpayer owed one creditor back rent and several past due bills for merchandise, the latter represented by interest-bearing notes. Both rent and interest had been deducted as expenses in the taxpayer's returns for the years in which they had accrued. In face to face dealings with the creditor, in conjunction with negotiations for a new lease, both items of indebtedness were cancelled upon payment of less than the face amounts.

The Court reasoned that the cancellation of indebtedness in a face to face transaction with the creditor was "the receipt of financial advantages gratuitously"[27] and hence a gift. The fact that the reasons or motives for the cancellation by the creditor might have been selfish was thought to be immaterial. Apparently, however, the Court thought that there was an "intent" to make a gift, and that "intent" was manifested by showing that the creditor cancelled a portion of the debt without receiving any valuable consideration.[28]

Later cases indicated that if there was consideration for the cancellation there could be no gift, and taxable income was received. It is not clear whether more than simple contract consideration was required or whether the consideration must have moved from the debtor.[29] And because of the necessity for a donative "intent," the *American Dental* rule was thought by some to be inapplicable

25 B. T. A. 127 (1932). See Reg. 111, § 29.22(a)–13(b) (1943). For criticism of the insolvency rules see the articles cited in notes 12 and 13 supra. For discussion of the effect of the National Bankruptcy Act, see Claridge Apartments Co. v. Com'r, 323 U.S. 141, 146 (1944); Lynch, Some Tax Effects of Cancellation of Indebtedness, 13 Fordham L. Rev. 145 (1944); Surrey, The Revenue Act of 1939 and the Income Tax Treatment of Cancellation of Indebtedness, 49 Yale L. J. 1153, 1184 (1940).

[25] 318 U.S. 322 (1943).

[26] 53 Stat. 10 (1939), 26 U.S.C.A. § 22(b)(3) (1948). Reg. 77, Art. 64, Rev. Act. of 1932, provided, "If . . . a creditor merely desires to benefit a debtor and without any consideration therefore cancels the debt, the amount of the debt is a gift from the creditor to the debtor. . . ." This provision was omitted in Reg. 86, Art. 22(a)–14, Rev. Act. of 1934, and it does not appear in the present Regulations.

[27] Helvering v. American Dental Co., 318 U.S. 322, 330 (1943).

[28] The taxpayer in the Jacobson case attempted to draw a distinction between the terms "donative intent" and "donative motive," claiming, "Petitioner is confusing the terms 'intent' and 'motive,' and is really saying that if the motive for the cancellation is a business one, the cancellation cannot be gratuitous. As this Court held in the American Dental Co. case, the motives are not controlling. The common, accepted definition of the term 'gift' shows that the motives of the donor have no bearing on whether a particular transaction is a gift. The significant fact is that in the present case the creditors intended to cancel a portion of their debt without receiving any valuable consideration. What their motives were is of no importance." Respondent's Brief in the Supreme Court, at p. 11.

[29] Compare Shellabarger Grain Products Co. v. Com'r, 146 F. 2d 177 (C.C.A. 7th, 1944); Reliable Incubator & Brooder Co., 6 T. C. 919 (1946); Liberty Mirror Works, 3 T. C. 1018 (1944).

where the cancellation was brought about by arm's-length, open-market transactions.[30]

In the *American Dental* case the Court recognized that where a debtor dealt directly with his creditor, cancellation would have been unlikely if the debtor had been well able to pay the full amount of the obligation. In keeping with the tendency of the courts to circumvent the *Kirby* rule in situations where the debtor was in difficult financial circumstances, the gift concept was developed. The use of the gift category made it unnecessary to go into the difficult fact questions of property valuation and insolvency that were involved in the two satellites of the *Kirby* rule.

Perhaps because it was simple to apply and did not aggravate the difficult financial circumstances of debtors, the lower courts began to apply the gift concept in a wide variety of cases. In some, the finding that there was a gift was far from realistic.[31] In others it was clear that the financial condition of the debtor had little or nothing to do with the cancellation.[32] More recently the Tax Court seems to have recognized these excesses and has attempted to develop some limitations upon the *American Dental* doctrine. Thus the doctrine was not applied where an open market existed for the cancelled obligations, regardless of whether they were purchased in that open market.[33] In another case it was held that there was income to the debtor from the purchase of its obligations at a discount where the debtor had not had close personal or business relations with the creditor.[34] And in the *Jacobson* case the Tax Court refused to apply the *American Dental* rule to bonds purchased for the taxpayer by his agents or by a bondholders' committee and found that only where the taxpayer personally made the purchase was there a gift.[35]

It was in this context that the Supreme Court, in the *Jacobson* case, after finding that taxable income had been realized by virtue of the cancellation, held that the income was not a gift and therefore taxable.

Section 22(b)(9) of the Code,[36] which provides for the exclusion from gross income of the gains arising from a corporation's purchase at a discount and can-

[30] Compare Fifth Ave.-Fourteenth St. Corp. v. Com'r, 147 F. 2d 453 (C.C.A. 2d, 1945).

[31] Manhattan Soap Co., T. C. Memo., Doc. Nos. 182, 112632, 112633, 3 T. C. M. 257 (1944), holding that a compromise settlement of a federal tax liability resulted in a gift to the taxpayer. Compare cases collected in Dunham, Cancellation or Adjustment of Indebtedness, 7th Annual N.Y.U. Inst. on Fed. Taxation 1346 (1949).

[32] McConway & Torley Corp., 2 T. C. 593 (1943), finding a gift where the debt of a wholly owned subsidiary corporation to its parent was cancelled at the instance of a creditor of the parent so that the subsidiary could declare a dividend which the parent could use to reduce its debt to its creditor.

[33] Warner Co., 11 T. C. No. 53 (1948).

[34] Edmont Hotel Co., 10 T. C. 260 (1948).

[35] Jacobson v. Com'r, 6 T. C. 1048 (1946). See note 2 supra. The court of appeals applied the American Dental doctrine to all of the purchases. 164 F. 2d 594 (C.C.A. 7th, 1947).

[36] 53 Stat. 875 (1939), 26 U.S.C.A. § 22(b)(9) (1948).

cellation of its own securities, served as the basis for one argument. The Court said that the Section described gains similar to those in the *Jacobson* case, and if that type gain when received by corporations was considered a gift within Section 22(b)(3), there was no need for Congress to provide a special exclusion in 22(b)(9).[37] A weakness of this argument lies in the identification of the gains in the *Jacobson* case with those covered by Section 22(b)(9). Corporations are more likely than individuals to acquire their own obligations in the open market. However, the gift concept is applicable to face to face transactions, not open-market transactions. Congress, in passing Section 22(b)(9), may have intended to extend some of the benefits of exclusion from gross income to cases in which 22(b)(3) was inapplicable. Furthermore, the tax consequences of 22(b)(3) and 22(b)(9) are different. The former results in a complete exclusion. On the other hand, 22(b)(9), coupled with Section 113(b)(3),[38] which requires that the basis of the corporation's property be reduced by an amount equal to the benefit arising from the cancellation,[39] results merely in a temporary exclusion. The gain is spread out over the life of the property by decreased future deductions for depreciation unless the taxpayer sells the capital asset. In that event the provisions covering adjustment of basis in 113(b)(3) assure the full realization of the gain, but the full gain will not be taken into account under the provisions of Section 117.[40]

The Court in the *Jacobson* case held that the facts did not present a proper situation in which to apply the *American Dental* doctrine. Although the debtor was in straitened financial circumstances, the property securing the bonds exceeded the amount of the indebtedness; that property produced some income; and the debtor was solvent at the time of the cancellation. Perhaps in the hope that future cases might develop a workable limitation on the *American Dental* rule, the Court did not overrule that case. Instead, it attempted to distinguish it, saying that the release of an open account for rent or for interest was more likely to be a gift transaction than the sale of outstanding securities. That each bondholder in the *Jacobson* case was acting from selfish motives was emphasized. Each was selling his bonds for the best price obtainable in the belief that by so doing he would secure the greatest possible advantage under his own particular circumstances.

The same may, however, be said of all such transactions arising in commercial contexts, including that in the *American Dental* case. In the business world, if the law is to be at all realistic, the concept of the "economic man" should not be by-passed. Until benevolent or personal motives appear—until the transaction becomes noncommercial—the creditor will only cancel indebtedness when he feels that he will minimize his probable losses or maximize his probable

[37] Com'r v. Jacobson, 69 S. Ct. 358, 366 (1949).

[38] 53 Stat. 875 (1939), 26 U.S.C.A. § 113(b)(3) (1948).

[39] See note 20 supra.

[40] 53 Stat. 50 (1941), 26 U.S.C.A. § 117 (1945), which provides for capital gain and loss.

gains.[41] He will make this decision either where he feels that the full amount of the debt will not be collectible when it falls due, where he wants the benefit of some money before the obligation matures, or because he feels that by not forcing payment in full he will be able to continue a profitable business relationship with the debtor.

It appears that the unrealistic concept of a "gift in the commercial world" has been abandoned, although it is true that the *Jacobson* decision did not expressly overrule the *American Dental* case.[42] If some satisfactory limitation of the gift concept is devised, it may be applicable to some cases. However, it is not likely that such a limitation will be formulated. If so, the answer to the question of when the cancellation of indebtedness results in taxable income is again to be found in the principle of the *Kirby* case and the two satellite concepts, constructed about reduction in purchase price and insolvency, that were developed around that principle prior to the *American Dental* decision.

RIGHTS OF BENEFICIARIES UNDER FACILITY OF PAYMENT CLAUSES

The plaintiff was the named beneficiary of four small industrial insurance policies which contained facility of payment clauses. The clauses provided that "[i]f the Beneficiary does not surrender this policy with due proof of death within 30 days after death of the insured, . . . the death benefit will, upon surrender of this Policy with due proof of death, be paid to the executor or administrator of the Insured, but . . . the Company may . . . pay the benefit to any relative by blood or connection by marriage . . . or to any person appearing to the Company to be equitably entitled . . . because of having incurred expense for . . . medical attention or burial of the Insured." The plaintiff, not possessing the policies, was unable to present them for payment within the 30-day period; she ultimately brought suit against the insurer and the person retaining the policies —the insured's widow. The company interpleaded the plaintiff, the widow, and the administrator, and paid the proceeds of the policies into court. It was held that upon the expiration of the initial 30-day period the beneficiary assumed a status under the facility of payment clause similar to that of any other person to whom the insurer might have elected to pay the benefits. The plaintiff accordingly had no right to compel payment, and since the insurer had failed to elect a recipient of the proceeds, only the administrator had a right to receive payment. *Matejicska v. Metropolitan Life Ins. Co.*[1]

Industrial insurance policies pay benefits averaging about $250; premiums

[41] Compare Haden Co. v. Com'r, 118 F. 2d 285 (C.C.A. 5th, 1941), cert. den. 314 U.S. 622 (1941) (decided before the American Dental case and holding that because the cancellation of indebtedness benefited the creditor, the cancellation did not constitute a gift).

[42] Justice Rutledge, concurring with the majority, was of the opinion that the two cases were inconsistent. Com'r v. Jacobson, 69 S. Ct. 358, 370 (1949).

[1] 335 Ill. App. 81, 80 N.E. 2d 278 (1948).

are usually collected weekly. Such protection is purchased by members of low income groups especially to cover funeral costs and the last expenses of the insured.[2] The facility of payment clause, which invariably appears in industrial policies, constitutes an appointment by the parties to an insurance contract of persons or classes of persons who may receive payment of the benefits. From the insurer's viewpoint, the purpose of these clauses is to permit prompt payment, to protect itself in making such payment, to avoid the delay attendant upon the administration of the insured's estate, and to remove the possibility of litigation between claimants and the insurer.[3] The social purpose of the clause is to meet such exigencies as usually arise in case of death,[4] and to eliminate the time and expense necessary for the administration of the estate, especially where there is no estate other than the proceeds of the policies. Policies similar to the instrument in the instant case generally include a named beneficiary as well as the facility of payment clause; others, lacking a beneficiary, authorize payment to the executor or administrator of the insured's estate if no election to pay is made under the clause; still other forms of policies include all potential recipients of benefits under the facility of payment clause.[5]

The insurer has an option in deciding whether to make payment and to whom payment will be made under the facility of payment clause even though the policy names a beneficiary.[6] Election and payment, if made in good faith, act to discharge the insurer from further liability under the contract of insurance.[7] In two Pennsylvania cases, however, the court treated the facility of payment clause as mere surplusage and concluded that good faith payment to

[2] Williams, Industrial Policies—Facility of Payment Clause, 18 Neb. L. Bull. 100 (1939); see Beard v. John Hancock Mut. Life Ins. Co., 326 Pa. 430, 192 Atl. 411 (1937); Pioneer Trust & Savings Bank v. Metropolitan Life Ins. Co., 278 Ill. App. 113 (1934); Zornow v. Prudential Ins. Co., 210 App. Div. 339, 206 N.Y. Supp. 92 (1924).

[3] Williams, op. cit. supra note 2; Fuller, The Special Nature of the Wage Earner's Life Insurance Problem, 2 Law & Contemp. Prob. 10, 29 (1935). For judicial recognition of insurer's purpose in including the facility of payment clause in industrial insurance, see Uptegrove v. Metropolitan Life Ins. Co., 145 Neb. 51, 15 N.W. 2d 220 (1944); Bragdon v. Prudential Ins. Co., 109 Ind. App. 278, 34 N.E. 2d 173 (1941); Zornow v. Prudential Ins. Co., 210 App. Div. 339, 206 N.Y. Supp. 92 (1924); Bishop v. Prudential Ins. Co., 217 Ill. App. 112 (1920).

[4] Prudential Ins. Co. v. Tomes, 45 F. Supp. 353 (D.C. Neb., 1942); Pioneer Trust & Savings Bank v. Metropolitan Life Ins. Co., 278 Ill. App. 113 (1934); Dorsey v. Metropolitan Life Ins. Co., 145 So. 304 (La. App., 1933); Prudential Ins. Co. v. Howell, 144 Okla. 166, 289 Pac. 734 (1930).

[5] See The Facility of Payment Clause in Industrial Life Insurance Policies, 32 Col. L. Rev. 1185, 1186 (1932).

[6] Jenkins v. Metropolitan Life Ins. Co., 113 Colo. 68, 155 P. 2d 772 (1944); Turner v. Prudential Ins. Co., 150 Kan. 899, 96 P. 2d 641 (1939); Moldovan v. John Hancock Mutual Life Ins. Co., 124 S.W. 2d 541 (Mo. App., 1939); Prudential Ins. Co. v. Brock, 48 App. D.C. 4 (1918).

[7] Minuto v. Metropolitan Life Ins. Co., 58 R.I. 71, 191 Atl. 117 (1937) (company held not warranted in paying executor without properly investigating who had actually paid funeral expenses); Dorsey v. Metropolitan Life Ins. Co., 145 So. 304 (La. App., 1933); In re O'Neill's Estate, 143 N.Y. Misc. 69, 255 N.Y. Supp. 767 (1932); Bishop v. Prudential Ins. Co., 217 Ill. App. 112 (1920).

one not the designated beneficiary did not relieve the insurer of liability to the named beneficiary.[8]

The courts are in general agreement that those persons who are mentioned only in the facility of payment clause have no right to enforce payment.[9] An impressive majority of cases indicate that the named beneficiary, rather than the administrator of the insured's estate or any other claimant, has the exclusive right to maintain an action for the proceeds of the policy when the insurer fails to elect to pay anyone.[10] A few distinguishable cases hold that the administrator may bring suit rather than the beneficiary.[11] Recognition of the administrator by the courts as the only person who may enforce payment under a facility of payment clause would defeat the social purpose of these policies; the appointment of an administrator necessitates weeks of delay and expenditures which may appreciably diminish the small estate represented in many instances only by the policy.

Occasionally insurers fail to make payment because of belief that there are two or more worthy claimants. While the insurers could relieve themselves from liability by making an election of an eligible party under the clause, the companies sometimes wait to be sued and then interplead all claimants. The problem of selecting a proper recipient of benefits is thus delegated to the court. Where the claimants in an interpleader action are the named beneficiary and the executor or administrator of the insured's estate, the courts usually award payment to the beneficiary.[12] Indeed, it has been held that the propriety of the beneficiary's claim in such circumstances is so apparent that interpleader will not be allowed.[13] In interpleader proceedings the courts seek to determine who

[8] Smith v. Metropolitan Life Ins. Co., 222 Pa. 226, 71 Atl. 11 (1908); McNally v. Metropolitan Life Ins. Co., 199 Pa. 481, 49 Atl. 299 (1901); cf. Capuano v. Boghosian, 54 R.I. 489, 175 Atl. 830 (1934).

[9] Morticians' Acceptance Co. v. Metropolitan Life Ins. Co., 321 Ill. App. 277, 53 N.E. 2d 30 (1944); Voris v. Rutledge, 297 Ill. App. 383, 17 N.E. 2d 622 (1938); Craig v. Metropolitan Life Ins. Co., 220 Mo. App. 913, 296 S.W. 209 (1927); Metropolitan Life Ins. Co. v. Chappell, 151 Tenn. 299, 269 S.W. 21 (1924).

[10] Chandler v. American Life & Accident Ins. Co., 96 S.W. 2d 883 (Mo. App., 1936); Capuano v. Boghosian, 54 R.I. 489, 175 Atl. 830 (1934); Smooth v. Metropolitan Life Ins. Co., 157 So. 298 (La. App., 1934); French v. Lanham, 57 F. 2d 422 (App. D.C., 1932); Washington Fidelity National Ins. Co. v. Heard, 148 Okla. 294, 298 Pac. 622 (1931).

[11] Plummer v. Metropolitan Life Ins. Co., 229 Mo. App. 638, 81 S.W. 2d 453 (1935) (named beneficiary was insured's divorced husband who had deserted her ten years previously); Schlereth v. Neely, 285 S.W. 168 (Mo. App., 1926) (heirs of predeceased beneficiary have no rights to compel payment as against administrator of the estate); McCarthy v. Metropolitan Life Ins. Co., 162 Mass. 254, 38 N.E. 435 (1894) (insurer had already made a valid election to pay when beneficiary brought suit).

[12] Jenkins v. Metropolitan Life Ins. Co., 113 Colo. 68, 155 P. 2d 772 (1944); Butler v. Fowler, 188 S.W. 2d 612 (Tenn. App., 1944); Turner v. Prudential Ins. Co., 150 Kan. 899, 96 P. 2d 641 (1939); Pashuck v. Metropolitan Life Ins. Co., 124 Pa. Super. Ct. 406, 188 Atl. 614 (1936); Ogletree v. Hutchinson, 126 Ga. 454, 55 S.E. 179 (1906).

[13] Golden v. Metropolitan Life Ins. Co., 35 App. Div. 569, 55 N.Y. Supp. 143 (1898); cf. Sampson v. Metropolitan Life Ins. Co., 36 Pa. Co. Ct. 481 (1909) (mother and beneficiary interpleaded).

is equitably entitled to payment. One who has paid the funeral expenses, a creditor of the insured, or a person who supported the insured prior to his death has such an equity.[14]

In litigation between beneficiaries or equitable claimants and those who have in fact received payment, the courts have held that the one chosen by the company to receive payment does not become vested with absolute ownership of the benefits but holds as agent or trustee for the party ultimately entitled to the proceeds.[15] Generally, a beneficiary named in the policy, or the estate of the insured if no beneficiary is named, may recover proceeds paid under the facility of payment clause if it can be shown that the recipient has no beneficial interest in the payments. The administrator, if paid, may be held to retain the funds for the use of the named beneficiary.[16] The administrator may also be held to retain part of the proceeds for one equitably entitled thereto.[17] A person receiving payment from the insurer may be required to pay any residue beyond the extent of his equitable interest to the beneficiary, or lacking the latter, to the estate.[18]

Under the particular facility of payment clause in the instant case, the company could not exercise its option to choose a relative or one equitably entitled to receive payment until after an initial 30-day period.[19] The usual facility of payment clause contains no such 30-day proviso. This restriction on the exercise of the insurer's option is apparently included for the benefit of the beneficiary since during the period the insurer is precluded from making payment to anyone other than the beneficiary. When the period has elapsed, the parties should occupy the same position as under the usual facility of payment clause.[20] If the insurer does not exercise its option under the clause after the initial period has expired—a privilege which is lost after suit has been initiated to compel pay-

[14] Brown v. Ehlers, 130 Neb. 918, 267 N.W. 156 (1936); Bojczuk v. Skradski, 137 Kan. 4, 19 P. 2d 468 (1933); Ellis v. Metropolitan Life Ins. Co., 3 S.W. 2d 397 (Mo. App., 1928). See The Facility of Payment Clause in Industrial Insurance, 14 Tulane L. Rev. 114, 118 (1939).

[15] Lutostanski v. Lutostanski, 120 Conn. 471, 181 Atl. 533 (1935); In re Van Pelt's Estate, 153 N.Y. Misc. 155, 275 N.Y. Supp. 317 (1934); Smith v. Massie, 93 Ind. App. 582, 179 N.E. 20 (1931); Blanchett v. Willis, 161 S.C. 83, 159 S.E. 469 (1931); Ogletree v. Hutchinson, 126 Ga. 454, 55 S.E. 179 (1906).

[16] French v. Lanham, 57 F. 2d 422 (App. D.C., 1932).

[17] In re Grasso's Estate, 178 N.Y. Misc. 114, 34 N.Y.S. 2d 58 (1941).

[18] Bragdon v. Prudential Ins. Co., 109 Ind. App. 278, 34 N.E. 2d 173 (1941); Apps v. Braun, 279 Mich. 221, 271 N.W. 739 (1937).

[19] Lain v. Metropolitan Life Ins. Co., 388 Ill. 576, 58 N.E. 2d 587 (1944), construing the same clause held that the beneficiary has a vested right if he produces the policies and proof of death within 30 days of insured's death. At the expiration of that period, if the beneficiary has not delivered the policies to the insurer, the latter may exercise its option under the facility of payment clause.

[20] The opinion of the court in the instant case seems to place a premium on the ability of the beneficiary to deliver up the policies within a month of the insured's death. This appears arbitrary, for the company may easily verify the beneficiary's claim for payment whether or not the beneficiary possesses the policies.

ment[21]—the clause has no effect on the rights of the parties, and the instrument is to be construed as if the facility of payment clause were not included.[22] Thus if the beneficiary has not claimed payment within the 30 days, and if the company has not exercised its option after the period has expired, only the beneficiary should have a right to institute proceedings to recover the proceeds of the policy. He should occupy the same status under these circumstances as the beneficiary under any ordinary policy of insurance. It follows that once proceedings were instituted, the beneficiary's right to payment should have been recognized as vested.

Consideration of the intention of the insured, the rights of the beneficiary under ordinary life insurance, and the purposes of small industrial policies, point to the need for recognition by the courts of a vested claim in the named beneficiary, subject to being divested upon payment by the insurer to one who has already supplied funds to accomplish the task for which the proceeds of the policy were intended. Recognition by the courts of a right of action in the beneficiary may well be an inducement to prompt payment and tend to restore the advantages to the insured's estate and loved ones which can arise from the inclusion of facility of payment clauses in industrial insurance policies.[23]

APPLICATION OF STRIKE SUIT STATUTES IN FEDERAL COURTS

The plaintiff, owning a fraction of one per cent of the stock in a Delaware corporation, filed, on diversity grounds, a derivative suit in a New Jersey federal district court against the corporation's officers and directors.[1] Before the determination of the suit, the New Jersey legislature passed a law requiring as a condition precedent to a derivative action that a plaintiff hold shares either worth $50,000 or constituting five per cent of the value of all outstanding shares.[2] Otherwise, the corporation might require that the complainant give security for "reasonable expenses," including counsel fees incurred by the cor-

[21] Prudential Ins. Co. v. McMahon, 60 R.I. 446, 199 Atl. 305 (1938); Pashuck v. Metropolitan Life Ins. Co., 124 Pa. Super. Ct. 406, 188 Atl. 614 (1936); Prudential Ins. Co. v. Tutalo, 55 R.I. 160, 178 Atl. 859 (1935); Prudential Ins. Co. v. Godfrey, 75 N.J. Eq. 484, 72 Atl. 456 (1909); Floyd v. Prudential Ins. Co., 72 Mo. App. 455 (1897). But see Slingerland v. Prudential Ins. Co., 94 N.J.L. 532, 110 Atl. 913 (1920) (mere assertion of a claim by beneficiary or administrator does not terminate company's right to make payment under the facility of payment clause).

[22] Uptegrove v. Metropolitan Life Ins. Co., 145 Neb. 51, 15 N.W. 2d 220 (1944); Pashuck v. Metropolitan Life Ins. Co., 124 Pa. Super. Ct. 406, 188 Atl. 614 (1936); In re O'Neill's Estate, 143 N.Y. Misc. 69, 255 N.Y. Supp. 767 (1932); Williams v. Metropolitan Life Ins. Co., 233 S.W. 248 (Mo. App., 1921).

[23] For a discussion of how the facility of payment clause is actually administered by the companies see Fuller, The Special Nature of the Wage Earner's Life Insurance Problem, 2 Law & Contemp. Prob. 10, 30 (1935).

[1] See Cohen v. Beneficial Industrial Loan Corporation, 7 F.R.D. 352 (1947).

[2] N.J. Rev. Stat. (Supp., 1947) tit. 14, c. 3, §§ 15, 17.

poration or by the defendant officers.[3] The corporation's motion for an order requiring the complainants to give $125,000 security was denied on the ground that the statute was "procedural" and, accordingly, not binding on the federal courts. On appeal by the corporate defendant, the plaintiff challenged both the constitutionality of the statute, particularly in its retroactive application, and its applicability in the federal courts. The Court of Appeals for the Third Circuit rejected these conditions and reversed the decision below. *Beneficial Industrial Loan Corporation v. Smith.*[4]

This decision departs from the approach of the district courts in the second circuit. There the application of the parent security bond statute, Section 61(b) of the New York General Corporations Act,[5] in federal courts with diversity jurisdiction was denied on the ground that the statute was purely procedural.[6] While perhaps in accordance with conflict of laws criteria,[7] these decisions have

[3] The corporation's by-laws included a provision under which the corporate officers were to be indemnified by the corporation for reasonable expenses, including counsel fees, incurred in successfully defending against claims and demands brought against them as officers of the corporation. This by-law, Article X, is set forth in the margin at page 48 of Beneficial Industrial Loan Corp. v. Smith, 170 F. 2d 44 (C.C.A. 3d, 1948).

[4] 170 F. 2d 44 (C.C.A. 3d, 1948).

[5] N.Y. General Corporations Law (McKinney, 1948) c. 22, § 61(b).

[6] Section 61(b)'s application in federal courts was tested in three cases: Boyd v. Bell, 64 F. Supp. 22 (N.Y., 1945); Craftsman Finance and Mortgage Co. v. Brown, 64 F. Supp. 168 (N.Y., 1945); and Donovan v. Queensboro Corporation, 75 F. Supp. 131 (N.Y., 1947). The Boyd case held that Section 61(b), being clearly remedial, was not applicable. The Donovan case held the statute applicable at the discretion of the judge. Judge Leibell in the Craftsman Finance case acknowledged the necessity of enforcing state policy but asserted that Federal Rule 23(c), 28 U.S.C.A. foll. § 723(c) (1948), requiring court approval of private settlements served much the same purpose as Section 61(b). This might be the case if one were to judge from such statements as that in part of Governor Dewey in signing the bill. N.Y. Times, p. 22, col. 4 (Apr. 12, 1944). However, it is apparent that the framers of this statute were as much concerned with groundless as with valid actions designed to enrich plaintiff's attorneys rather than the corporation. See Wood, Survey and Report regarding Stockholders' Derivative Suits (1944). The Wood Report, undertaken for the New York State Chamber of Commerce, the sponsor of the bill, formed the basis for the security bond legislation.

In Aspinook v. Bright, 165 F. 2d 294 (C.C.A. 2d, 1947) the second circuit court of appeals has expressed approval of the district courts' holdings. After declining to entertain an immediate appeal, the court was asked by the corporation to issue a mandamus to the district court requiring it to exact security requirements (as under Section 61[b]) on the ground that the plaintiff stockholder may fail to appeal an adverse verdict, saddling the corporation with its officers' expenses under Section 64 of the General Corporations Act. The court refused to hear the petition for mandamus. In a dictum the majority called attention to the possible unconstitutionality of the statute. Frank, J., concurring, would have considered the mandamus petition on its merits holding the statute inapplicable in federal courts.

The U.S. Supreme Court has granted certiori to Cohen v. Beneficial Industrial Loan Corporation, 69 S. Ct. 642 (1949). Presumably, the conflict between the circuits was one of the reasons.

[7] The conflict of laws rule is, of course, that the procedural rules of the forum prevail. However, it is increasingly evident that there exist numerous rules procedural in that they do not define causes of action, that express fundamental policies of jurisdictions. The result is that courts classify these rules (such as those concerning burden of proof of absence of contributory negligence, res ipsa loquitur, etc.) more and more as lex loci. A comprehensive dis-

been criticized as antagonistic to the approach reflected in *Erie Railroad v. Tompkins*[8] and culminating in *Angel v. Bullington*[9] where the Supreme Court has defined the discretionary powers of federal courts with diversity jurisdiction in increasingly narrow terms, terms totally independent of the procedural-substantive dichotomy.[10]

Under the doctrine of these cases, federal courts exercising diversity jurisdiction are to apply state rules reflecting important state policies. "The essence of diversity jurisdiction is that a federal court enforces State law and State policy."[11] The classification of a law as "merely procedural" will not result in its being ignored by federal courts so that "the accident of citizenship becomes decisive of the litigation."[12] A federal court with diversity jurisdiction does not, under the rules of the *Erie* and *Angel* cases, act as independently as would a state court applying foreign law.

The court in the instant case recognized this when it stated the crucial question as ". . . can [the plaintiff] escape the limitation of the New Jersey statute by entering the federal court house rather than that of the State?"[13] Its negative

---

cussion of this problem is found in Sampson v. Channel, 110 F. 2d 754 (C.C.A. 1st, 1940), a case demonstrating that the rigorous substantive-procedural categories are breaking down. In the Sampson case the problem arose of application of state conflict of laws rules by federal courts with diversity jurisdiction. There was an automobile collision in Maine, where the burden of proving the absence of contributory negligence rests on the plaintiff. The case was tried before a federal district court in Massachusetts where that burden is on the defendant and where the evidentiary rule is regarded as procedural. The result was that the Massachusetts court used the local rule even where the cause arose in a foreign state with the opposite rule. On appeal, Magruder, J., held that the Massachusetts conflict of laws rule was substantive for this case and therefore binding on federal courts. An excellent theoretical discussion of this question is found in Cook, The Logical and Legal Bases of the Conflict of Laws c. vi (1942). See also Morgan, Choice of Law Governing Proof, 58 Harv. L. Rev. 153 (1944).

[8] 304 U.S. 64 (1938).

[9] 330 U.S. 183 (1947). See also Guaranty Trust Co. v. York, 326 U.S. 99 (1945), requiring federal application of state statutes of limitation in a case where the federal rule would not have barred the action.

[10] See Tunks, Categorization and Federalism: "Substance" and "Procedure" after Erie Railroad v. Tompkins, 34 Ill. L. Rev. 271 (1939). Professor Moore has criticized the second circuit cases as being directly contrary to Angel v. Bullington. 3 Moore, Federal Practice 3504 et seq. (2d ed., 1948). He also discusses a parallel problem (ibid., at 3489 et seq.), the application of Rule 23(b) of the Federal Code of Civil Procedure, requiring that Plaintiffs be shareholders at the time of the transactions complained of, to cases where federal jurisdiction is based on diversity. Here too, the cases have been decided mechanically, with emphasis on the procedural context of the rule rather than the operative effect on the substantive rights of the parties. Yet Dean Pound has said the rule has its basis "in a sound and wholesome principle of equity." Fire Insurance Co. v. Barber, 67 Neb. 664, 658, 93 N.W. 1024, 1029 (1903). Professor Moore appears to favor a limited application of Rule 23(b) in subordination to the enforcement of state policy in questions decided under diversity jurisdiction.

[11] Angel v. Bullington, 330 U.S. 183, 191 (1947). The Supreme Court held here that if a state gives no remedy without abolishing the cause of action itself, federal courts cannot give relief. This holding is of critical importance, demanding as it does that federal courts with mere diversity jurisdiction make a serious attempt to enforce state policy.

[12] Sampson v. Channel, 110 F. 2d 754, 758 (C.C.A. 1st, 1940).

[13] Beneficial Industrial Loan Corp. v. Smith, 170 Fed. 2d 44, 54 (C.C.A. 3d, 1948).

answer appears to be well within a proper interpretation of the *Erie* doctrine, it being universally accepted—both by the statute's supporters and critics—that it profoundly influences the stockholders' derivative action.[14] The security bond statutes were viewed by their framers as an important extension of previous remedies against unjustifiable litigation and abuse of process.[15] The ordinary remedy of indemnification through assessment of court costs against unsuccessful plaintiffs was notoriously inadequate, usually representing a nominal sum.[16] An action in tort for unjustifiable litigation is almost invariably inappropriate or useless.[17]

The court found that the statute was but an extension of the New Jersey statute "by which the court of chancery in New Jersey is empowered to award counsel fees and costs between party and party."[18] The New Jersey Supreme Court has upheld the constitutionality of the latter provision as applied to pending actions. It followed that the retroactive provision in question was also constitutional. But the position of the corporation is so greatly improved by the statute that it might be considered to have achieved a new "substantive right." This is—at least by implication—the view of the New York State Court of Appeals.[19] Similarly, the potential liability imposed by the law on the plaintiff could be said to effect a substantive change in his legal rights.[20] These considerations might well move an unsympathetic court to hold the retroactive application of the security bond statutes unconstitutional.[21] The Court of Appeals for

[14] The opponents of this statute would appear to regard it as a disastrous obstacle to the effective enforcement of the fiduciary obligations of corporate officers. Zlinkoff, The American Investor and the Constitutionality of Section 61-b of the New York General Corporation Laws, 54 Yale L.J. 352 (1945); Hornstein, New Aspects of Stockholders' Derivative Suits in New York, 47 Col. L. Rev. 1 (1947); Hornstein, Death Knell of Stockholders' Derivative Suits in New York, 32 Calif. L. Rev. 123 (1944).

Its supporters regard it as the answer to abuses of the grossest nature, particularly in connection with unethical legal practices. See Governor Dewey's statement, op. cit. supra note 6; Wood Report, op. cit. supra note 6.

[15] See citations in second paragraph of note 14 supra.

[16] Prosser, Torts 886 (1941); McCormick, Damages c. 8 (1935).

[17] See op. cit. supra note 16.

[18] N.J. Rev. Stat. (1937) tit. 2, c. 29, § 131.

[19] See Shielcrawt v. Moffett, 294 N.Y. 180, 61 N.E. 2d 435 (1945). Here Chief Justice Lehman speaking for the New York Court of Appeals sidestepped the constitutional problems of retroactive application by holding that a statute not in terms retroactive should not be construed as such. The lower court had held Section 61(b) unconstitutional on the basis of its application (as construed below) to pending suits. 49 N.Y.S. 2d 64, aff'd 268 App. Div. 352, 51 N.Y.S. 2d 188 (1944). The court reversed on the ground that the statute was not retroactive, obviously having serious doubts as to the constitutionality of retroactive provisos.

[20] Thus, in the present case the plaintiff was required to post $125,000 with no prospects of real personal gain even in the event of a court victory. Of course, this doesn't preclude the very substantial counsel fees which undoubtedly would still serve as a great incentive to attorneys to instigate derivative actions.

[21] The number of pending actions is necessarily very limited. Consequently, the invalidity of the retroactive provision of the New Jersey statute, if declared, would have no real effect

the Third Circuit in finding for its constitutionality chose to emphasize the statute's role as an implementation of previous remedies against litigious harassment.[22]

RESTRAINTS ON ALIENATION OF STOCK CERTIFICATES

In *Tracey v. Franklin*,[1] two stockholders had placed a majority of shares of class B stock of a Delaware corporation in a voting trust, naming themselves co-trustees. Class B was entitled to elect two of seven directors. The agreement provided that during the trust period of ten years the parties, as depositing stockholders, would not "sell their respective stock so deposited . . . [nor] their respective voting trust certificates . . . nor any interest in the shares of stock represented thereby. . . ."[2] As trustees, they agreed not to sell the stock deposited in trust except upon the consent given and terms stipulated by both depositing stockholders. Upon the death of either party, the survivor was to have an option to purchase the interest of the decedent. No other stockholder was to be admitted into the trust.

In a suit for specific performance by one of the parties, the Delaware Court of Chancery held that the restrictions upon the alienation of the stock interests as represented by the trust certificates were "unreasonable" and nonseparable, and that the entire trust agreement was therefore void.

Although it has been said that in the general field of restraints on alienation, "courts must . . . examine economic and social policy to a greater extent than in many other fields,"[3] the doctrine against restraints on stock transfer has never been explicitly analyzed in the light of the objectives underlying the policy against restraints. Thus, without such analysis, restraints have been invalidated merely on the ground that "the right to transfer is a right of property" and that an unreasonable restraint "amounts to an annihilation of property."[4]

---

on the general objectives which it seeks to attain. It would seem particularly harsh to impose these stringent new requirements on plaintiffs who have already changed their position in reliance on the previous derivative suit mechanism.

[22] The Supreme Court, in an opinion published too late for comment in the foregoing note, has affirmed the third circuit court of appeals. Beneficial Industrial Loan Corporation v. Smith, 17 U.S.L. Week 4530 (1949). The majority held that the order denying security could be directly appealed (contra: Aspinook v. Bright, op. cit. note 6); that the statute did not violate substantive due process; and that it represented an important state policy and should consequently apply in federal courts with diversity jurisdiction under the Erie rule as developed in the Angel and York cases. Rutledge, J., in his dissent decried the increasingly broad application of the Erie rule, stating that it was not intended to interfere with federal court procedure.

[1] 61 A. 2d 780 (Del. Ch., 1948). [2] Ibid., at 781.

[3] Manning, The Development of Restraints on Alienation since Gray, 48 Harv. L. Rev. 373 (1935).

[4] Penthouse Properties v. 1158 Fifth Avenue, 256 App. Div. 685, 11 N.Y.S. 2d 417, 422 (1939), citing Fisher v. Bush, 35 Hun. (N.Y.) 641 (1885); cf. People ex rel. Malcom v. Lake Sand Corp., 251 Ill. App. 499 (1929); Searles v. Bar Harbor Banking & Trust Co., 128 Me.

One common objection to restraints on alienation is that property should be free to answer for the debts of the owner.[5] The possibility of protecting property from creditors by means of the restrictions imposed by a spendthrift trust was Gray's chief argument against that device.[6] Restrictions so imposed are valid against both voluntary and involuntary transfers.[7] On the other hand, restrictions on transfer of stock certificates are enforceable only against voluntary transfers and not against judicial sales for the benefit of creditors.[8]

A second argument against restraints is that an economic system built upon freedom of commerce requires readily marketable property.[9] Any limitation on marketability restricts the number of possible alternate uses to which the restricted property can be put and may thereby prevent the most effective allocation of resources. However, the adverse effects of noneconomic diversion of resources ensue only where the restricted property constitutes a significant proportion of the class of property suitable for the use barred by the restriction. The usual economic effect of restraints is simply an upward adjustment in the price of similar property not so restricted. However, the policy of the law appears to be to frustrate attempted restraints at their beginnings, regardless of immediate economic effects, the theory probably being that by such vigilance the broader, more objectionable restraints on competition can be more easily prevented.

The "property" contemplated by this argument would not seem to include corporate stock. It is true that control of the majority of stock of a corporation assumes effective control over the underlying property, but it does not follow that a restraint on stock transfer constitutes a restraint on the disposition of the underlying property. Whatever the particular incidents of the stock ownership may be, the corporate property itself will be utilized to the economic advantage of the corporation as the majority stockholders view it, and, if an otherwise

---

34, 145 Atl. 391 (1929); State ex. rel. Howland v. Olympia Veneer Co., 138 Wash. 144, 244 Pac. 261 (1926); Scruggs v. Cotterill, 67 App. Div. 583, 73 N.Y. Supp. 882 (1902); Bloede Co. v. Bloede, 84 Md. 129, 34 Atl. 1127 (1896); Bank of Atchison County v. Durfee, 118 Mo. 431, 24 S.W. 133 (1893); In re Klaus, 67 Wis. 401, 29 N.W. 582 (1886).

Shares of Stock are personal property by statute (e.g., Del. Rev. Code [1935] § 2048) and at common law. Cook, Corporations § 331 (8th ed., 1923). Compare McNulta v. Corn Belt Bank, 164 Ill. 427, 447, 45 N.E. 954, 959 (1896).

But in Gray, Restraints on Alienation § 29d (2d ed., 1895), it is said: "The interest of a partner in a partnership, or of a shareholder in an unincorporated or corporated company, may . . . be made non-assignable. In the absence of agreement the right of a partner is generally presumed to be non-assignable, and of a shareholder to be assignable; but this may in both cases be changed by the terms of the articles or by-laws. The law does not force fellowship on any one without his consent."

[5] Manning, op. cit. supra note 3, at 403.

[6] Gray, Restraints on the Alienation of Property, Preface viii–ix (2d ed., 1895).

[7] Griswold, Spendthrift Trusts §§ 265, 267 (1936).

[8] McDonald v. Farley & Loetscher Mfg. Co., 226 Iowa 53, 283 N.W. 261 (1939); cf. First Nat. Bank of Canton v. Shanks, 34 Ohio Ops. 359, 73 N.E. 2d 93 (1945).

[9] Manning, op. cit. supra note 3, at 403.

competitive market is assumed, this allocation of resources will be most advantageous to society as a whole. In short, a restraint on stock transfer is no direct restriction on the marketability of the corporate property; nor is it a limitation on the alternate productive uses to which corporate property may be put.

Only one argument for the rule against restraints on stock transfer considers policy as it relates to the corporation, namely, that the power freely to transfer one's stock and the power to acquire a larger block may be the only effective safeguards available to the small investor who fears management policies will lead to corporate loss.[10] Arguably, these safeguards are dubious in the case of the small or closely held corporation whose shares are not readily marketable even without restraints. On the other hand, it may be urged that when the property is not readily marketable initially, additional obstacles should not be imposed by agreement.

While the courts have not supported their assumption that the general rule against restraints is applicable to corporate stock they have had to turn to policy in their attempts to define the scope of reasonable and allowable restraints. It has been observed that this shift in attention has been marked by increasing liberality in the courts when passing upon the validity of restrictive agreements involving corporate interests, the power granted to employ voting trusts being cited as an example.[11]

The reasonableness of restraints on stock alienation is said to turn upon whether the given restraint is "necessary and convenient to the attainment of the objects for which the company was incorporated."[12] Such restrictions may be imposed by charter, by-laws, or agreement.[13] The corporate "necessity and convenience" served may be administrative: thus, a provision requiring the registration of shares with the management so that it may know who are the shareholders of record is valid as a reasonable restraint.[14] But corporate necessity and convenience of a different order may support another class of restraints. Restrictions are valid which create a preferential option to purchase in favor of corporation, directors, or shareholders; the giving of notice of intention to transfer; the resale of stock to the corporation by employee-stockholders upon the termination of employment; a prohibition against transfers to any but members of a limited class; the reservation in corporation or stockholders of the right to purchase shares of a decedent stockholder; and restrictions on transfer of shares not fully paid for.[15] This class of restraints is designed to afford stockholders

[10] Ballantine, Corporations 777 (rev. ed., 1946).

[11] Lawson v. Household Finance Corp., 17 Del. Ch. 343, 353, 152 Atl. 723 (1930).

[12] Ibid., at 352, 727.

[13] While the source of the restriction has apparently had influence in determining its validity in some cases, such distinction should probably not be controlling. Ballantine, Corporations 779 (rev. ed., 1946).

[14] 8 Fletcher, Cyc. Corp. § 4206 (perm. ed., 1931).

[15] Ballantine, Corporations § 337 (rev. ed., 1946).

"protection . . . against possible injurious changes in the control and management of the corporation, and [some] power to select one's associates, an advantage possessed by partnerships but usually not available to corporations."[16] In upholding these restraints, the courts place less emphasis upon the attributes of stock as personal property and more upon its nature as an interest in an enterprise, comparing it to a partnership interest. As Chief Justice Holmes of the Massachusetts Supreme Court declared in a frequently cited passage, "Stock in a corporation is not merely property. It also creates a personal relation analogous otherwise than technically to a partnership. There seems to be no greater objection to retaining the right of choosing one's associates in a corporation than in a firm."[17] Where the partnership analogy is accepted it would support a requirement that all shareholders consent to transfers of stock, since consent is necessary for the transfer of a partnership interest if the partnership is not to be dissolved. However, the courts do not follow the partnership analogy this far.[18]

This analogy of stock interests to partnership interests is more likely to be employed in upholding a restraint when the number of stockholders is small,[19] or when the stock concerned is that of a closed corporation,[20] or when the restraint in question effects an identity of ownership with control in the corporate structure.[21]

In view of these considerations, the *Tracey* case may be criticized not only for its failure to examine the economic and social policy served by the rule against restraints on stock alienation, but also for its failure to examine the reasonableness of the particular restraints involved in the light of the objectives they sought to attain.

The restrictions involved in the instant case were imposed through a voting trust agreement. Since the voting trustees were also the holders of the equitable interest, the voting trust did not operate to separate control and equitable own-

[16] Restrictions on Transferability of Shares of Stock, 42 Harv. L. Rev. 555, 556 (1929). In Lawson v. Household Finance Corp., 17 Del. Ch. 1, 13, 147 Atl. 312, 317 (1929), a case extensively drawn upon in the instant case, the Delaware court said "such a purpose is manifestly commendable." However, in Greene v. E. H. Rollins & Sons, 22 Del. Ch. 394, 2 A.2d 249 (1938), relied upon in the present case, the Lawson case was narrowly limited to its facts and it was pointed out that a small loan company, involved in the Lawson case, had an unusually strong reason for desiring to maintain the integrity of its stockholding class.

[17] Barrett v. King, 181 Mass. 476, 479, 63 N.E. 934 (1902). In the early history of American corporations, this "right to choose one's associates" was exercised to prevent stock subscription by speculators and other undesirables, but not without risk of being charged with monopolizing. 2 Davis, Essays in the Earlier History of American Corporations 321 (1917).

[18] In re Klaus, 67 Wis. 401, 29 N.W. 582 (1886); cf. Miller v. Farmers Milling & Elevator Co., 78 Neb. 441, 110 N.W. 995 (1907) (consent by directors required).

[19] 87 U. of Pa. L. Rev. 482, 483 (1939), noting Greene v. Rollins & Sons, 22 Del. Ch. 394, 2 A. 2d 249 (1938.)

[20] Ibid. [21] Ibid.

ership (the most objectionable characteristic of voting trusts),[22] but to consolidate the powers of the holders of a majority of shares of class B stock. In view of settled policy in Delaware as to the validity of voting trusts, the restrictions on transfer of interest could be viewed as a guaranty to each of the parties that the other, who, as voting trustee, was to share responsibility in the voting of class B, would, at all times, maintain a financial interest in the success of the enterprise. It has been said that restrictions on stock transfer designed to assure the corporation of management by persons "animated by a deep personal interest"[23] are "manifestly commendable."[24] Similar objectives were being pursued in the present case. By guaranteeing the unitary voting of class B stock, the restraints may have promoted the further commendable objectives of securing for that minority class of stock more effective representation on the board of directors.

Had the parties here not tried to restrict the alienability of the trust certificates, or, as is conceivable, had the restraints been found to be not so essential as to render the entire trust void by their invalidity,[25] it would have been possible for one or both of the parties to sell their equitable interests, retaining representation in the corporation as voting trustees. While such arrangements are generally valid, the great weight of criticism that has been thrown against the separation of control and equitable ownership through the voting trust device[26] suggests that an attempt by the agreement of the parties to prevent such separation should be considered reasonable. Of course, the foregoing analysis assumes that the primary objective of the parties was to establish the voting trust and that the restraint on alienation was an incidental feature operating to fuse voting power and ownership. The obvious difficulty with this analysis is that there is no indication as to which of these objectives was the primary agreement. The court's holding that the alienation provisions were an inseparable part of the total agreement suggests that in its view the restraints on alienation were of coordinate, if not of primary, importance. If this were not the view of the court, the voting trust agreement need not have been invalidated.

Whether strong policy arguments support the rule in the *Tracey* case may be

[22] The "separation of ownership and control" is one of the most important effects of a voting trust, according to Leavitt, The Voting Trust 7 (1941), and the resulting minority control is "the weightiest single factor" against the use of voting trusts. Ibid., at 166. The debate over the validity and value of the voting trust has been long and drawn out.

In 1937, Commissioner (now Justice) William O. Douglas characterized the voting trust as "a vehicle for corporate kidnapping." N.Y. Times, p. 37 (March 25, 1937). But Dewing declares, "Everything in this world of ours is subject to the dangers of abuse, from man's procreative powers to gooseberry tarts at Thanksgiving." 1 Dewing, Financial Policy of Corporations, 129 note y (4th ed., 1941). For a summary of the debate that has raged over voting trusts and citations to writings in the field, see Leavitt, The Voting Trust c. viii (1941).

[23] Lawson v. Household Finance Corp., 17 Del. Ch. 1, 12, 147 Atl. 312, 317 (1929).

[24] Note 11 supra.

[25] Tracey v. Franklin, 61 A. 2d 780, 785 (1948).

[26] Note 22 supra.

tested in another way. Voting trusts are not generally considered to be "genuine" trusts.[27] However, the rule—that restraints on alienation of the beneficial interest of stock are unreasonable when similar restraints against the stock itself would be unreasonable—could be applied equally well to the interests in a genuine trust. Provisions in a genuine trust agreement would be analogous to those in the voting trust agreement in the present case if the beneficiary were restrained from transferring his beneficial interest in the trust property, e.g., shares of stock. Statutes in some states permit such restraints against the beneficiary of a trust established to collect rents and profits.[28] A few states specifically forbid the transfer of the beneficial interest by the beneficiary of a trust created to receive income and profits to be applied to the use of another.[29] In legalizing spendthrift trusts, courts and legislatures have decided that individuals considered by the settlor to be inexperienced or wasteful are to be protected from the rule against restraints on alienation even though the property placed in trust may support strong policy arguments for that rule.[30] Absent more clearly articulated objections to restraints on stock transfer, the upsetting of a voluntary agreement, that operates to assure the identity of voting rights and ownership, is questionable.

When the legality of a given restraint on stock transfer is before the courts, a satisfactory result would seem more likely to be assured by a close examination of the particular restraint sought to be imposed and the special corporate purposes such restraint was designed to serve. If such should become the rule of the courts, not only might the boundaries of "reasonable" restraints become more sharply outlined, but the whole policy against restraints on alienation of property in general, as well as corporate stock, might be exposed to view: "A standard based on the purposes of the restraints should make it more imperative for the judges consciously to weigh the benefits involved and rationally to expound their results."[31]

[27] But see Gose, The Legal Characteristics and Consequences of Voting Trusts, 20 Wash. L. Rev. 129 (1945).

[28] Bogert, Trusts § 72 (2d ed., 1942).

[29] Ibid.

[30] Ibid., at § 45.

[31] Manning, op. cit. supra note 3, at 406.

BOOK REVIEWS

Understanding the Securities Act and the S.E.C. By Edward R. McCormick. New York: American Book Co., 1948. Pp. viii, 327. $7.50.

In spite of the favorable auspices under which the Securities Act of 1933 was sponsored and ultimately enacted, its adoption caused considerable concern, if not consternation, in investment banking circles. Although there was a general recognition of the need of some effective Federal legislation to govern the sale of investment securities to the public, it was felt by many connected with the securities business (e.g., investment bankers, lawyers, accountants, and engineers) that the Act would lead to delay, confusion, and added expense, and would constitute a serious impediment to the business of promoting the nation's financial transactions. Not so long after the Act was put into effect, Mr. James M. Landis, the Chairman of the Federal Trade Commission, which was originally charged with the administration of the Act, appeared before a large and representative group of Chicago businessmen to explain in a general manner the operations of the new law. It can fairly be said that Mr. Landis was met with considerable hostility, and, although it was generally recognized that he gave a brilliant analysis of the Act, many of his listeners came away continuing to believe that the Act would do more harm than good. Fifteen years have served to convince most of the critics of the Act that it is indeed an enlightened piece of legislation, and that it should have been enacted many, many years sooner.

Mr. McCormick's new book, in a quiet, logical, and convincing manner, serves to remind us again of the reasons legislation in this field was required. He has very properly devoted an introductory section to point out again the evils which the Act sought to correct. The history of English laws relating to the issuance and trading of corporate securities (where the problem was tackled in 1696 rather than 1933!) is highlighted; the inadequacy of the state Blue Sky Laws is touched upon; the over-all objectives of the Federal Securities Act are set forth. The Securities Act of 1933 is essentially an act requiring full and fair disclosure of pertinent information relating to securities sold in interstate commerce and through the mail. Its objective is to prevent fraud in the sale of these securities by forcing the seller to tell all relevant facts about them. Mr. McCormick says: "The basic policy underlying the Act is that of informing the investor of the facts concerning securities and providing protection against fraud and misrepresentation. Its objectives are to prevent the exploitation of the public by the sale of securities through misrepresentation, to place adequate and true information before the investor and to protect legitimate enterprises against the competition of fraudulent promoters in the sale of securities to the public." Although these objectives are sometimes overlooked in the busy work-a-day world, no investment banker, accountant, or lawyer of integrity, and certainly no business corporation operated by an honest managment which requires additional capital for legitimate business purposes, can take issue with the need and propriety of legislation effectuating this basic policy. For those who may have forgotten or may have never thoroughly understood the pur-

poses of the Act, Mr. McCormick's book is an excellent restatement which should be read and studied.

In reviewing the historical background of the legislation, Mr. McCormick not only recalls the need for full disclosure and publicity in the sale of securities, but also describes the lack of any effective remedy for the gullible investor prior to the enactment of the law, and graphically illustrates why the investor needed more effective remedies to redress the wrongs inflicted upon him through the purchase of fraudulent securities. In the exhaustive chapter on the civil liabilities imposed by the Act, the reader is reminded of the relatively helpless position the defrauded investor found himself in because of the burden of proof he was required to sustain as plaintiff. The Securities Act now gives him an effective remedy, in fact, a very potent one. The chapter of the book on civil liability analyzes this remedy, and also undertakes to sound a very important warning to persons involved in floating securities. One of the most serious criticisms of the Act stemmed from the very severity of this portion, but since the liability imposed can be avoided by the exercise of common honesty, decency, and integrity, the possible hardship to those connected with the sale of securities is a cheap price to pay for the protection given the innocent investor who supplies the funds for so many businesses upon which the financial security of the nation rests. As a matter of fact, by merely putting the fear of personal liability into the minds of those engaged in the sale of securities, the Act has effectively accomplished one of its major purposes, so that the investor automatically is protected before rather than after the purchase.

The Federal Securities Act of 1933 differs quite materially from the English laws having the same objective. Mr. McCormick points out that the Securities Act obtains its objective of full and fair disclosure not merely by providing legal sanctions for failure to disclose, but through the cooperation of those regulated and with the help of an efficient administrative body. Administrative authority is given to the Securities and Exchange Commission not only to make the necessary rules and regulations for the administration of the Act, but also to examine registration statements to determine whether they are accurate and complete on their face. Mr. McCormick recognizes that "much of the success of this legislation depends upon the alertness, aggressiveness and ability of the administrative personnel." While the responsibility of the Commission and its personnel is recognized, the book might, perhaps, have pointed out more emphatically the vital position which the Commission occupies in our American system of private economy. Although the Commission does not have specific power to pass on the merits of the securities offered for sale, it could easily, through an over-technical, unsympathetic, or recalcitrant administration, block the all-important vehicles of fund raising upon which our economic life must depend. Actually, the Commission possesses one of the most powerful instruments for good or evil in our capitalistic system. It seems fair to say, however, that even if this basic insight might have been stressed somewhat more persistently in the book, the personnel of the Commission, including particularly Mr. McCormick himself, have fully recognized their heavy responsibility, have given the Act a fair administration, and, in so doing, have done much to overcome the hostility which was directed against the Act and the Commission in the early stages of their history. It would, of course, be ridiculous to assume that all of those who have dealt with the Commission and its personnel have come away with the belief that all is sweetness and light; yet it must be recognized by any impartial person who has dealt with or observed the functioning of the Commission under the Securities Act of

1933, that not only has the Commission and its staff possessed ability, alertness and aggressiveness, but it has combined these qualities with a full recognition of the objective of the Act and a fundamental fair-mindedness in the administration thereof. If Mr. McCormick's book serves no other purpose (and it has many others), it must demonstrate conclusively the essential sincerity and underlying integrity of the Commission and its personnel.

Mr. McCormick's book has four sections: the introduction, which discusses the historical background (previously commented upon) and general information with respect to the Act and the Commission; an interpretation of the Act; a section on the manner in which the Act has been applied; and a section devoted to the criticisms which have been leveled at the Act.

The second section is technical in its nature in that, true to its name, it interprets the provisions of the Federal Securities Act of 1933, as amended. The book is its own best spokesman; to summarize would be to exceed the realm of a review. Suffice it to say that each section of the Act is discussed in detail. The discussions are most valuable, since they carry the reader from a bare statement of the Act to a thorough explanation of its operation. The discussion is particularly useful, since many of the sections of the Act, such as the definition of "securities," "issuers," "underwriters," and particularly "securities exempted" and "transactions exempted," are self-executing. The practitioner who is consulted on problems arising under these sections must make his own decisions as to whether the Act is applicable, and he can receive no better instructions on the serious problems which frequently arise than to seek Mr. McCormick's help as given in this portion of the book. As previously stated, the chapter devoted to civil liability must be studied by lawyers who have work in this field, not only for the protection of their clients and those associated with the client, but also for their own personal protection. Mr. McCormick succeeds in making this section particularly vivid, and anyone who reads the chapter should have a sympathetic understanding of the reasons for imposing the liability, and will also have a guide as to how the obligations under the Act may best be discharged.

The third section of the book is a collection of examples of the type of work which the Commission undertakes in examining registration statements. Mr. McCormick has chosen a series of actual registration statements which have been filed with the Commission and which show exactly the material presented to the Commission and its manner of treatment. This is an extremely entertaining section; not only does it illustrate the problems which the practitioner encounters, but it also demonstrates the reasonable approach which the Commission has taken toward these problems. One need only read some of the fantastic material submitted to the Commission to realize that disclosure of full information in connection with the sale of securities to the public will always be a crying need to protect a system of economy which depends, as does ours, on the investment of capital in private corporations. Mr. McCormick's treatment is very effective in that he sets forth the facts, gives the Commission's rulings, and lets the reader draw his own conclusions. Mr. McCormick has selected examples where the Commission's rulings have been eminently proper; he has not set forth some of the examples wherein the Commission's orders have been irritating rather than necessary —instances where the Commission has verged on the arbitrary in connection with accounting procedure; where insistence upon information has done more to help the competitor than to inform the prospective purchaser; instances of minor mechanical

deficiencies which have sometimes evoked unnecessarily annoying and expensive rulings. (In order to flag a provision of preferred stock which the Commission properly felt should be explained to prospective purchasers of common stock, it was necessary to meet the deficiency not only by stating the provision in question on the facing sheet when the preferred stock was first mentioned, but to place an asterisk and footnote on every single page on which the reference to preferred stock was mentioned, 51 asterisks in all, to be exact! *Carpenter Paper Company*, 2-6112.) The examples given by Mr. McCormick, and his discussion of the subject, indicate that even though there may be delay, expense, annoyance, and sometimes hardships to which a legitimate enterprise may be subject, it is a small price to pay for the protection the investor receives against the careless, avaricious, or fraudulent security salesman.

The Securities Act of 1933 was not, when enacted, and is not even today, without its critics. In the fourth section of the book, Mr. McCormick faces the most important criticisms leveled at the Act—mentioned above—and, it is submitted, comes out well. Surely he has refuted the critics forthrightly and with conviction.

Mr. McCormick states that the book was written "in part to assist the corporation official, investment banker, lawyer or accountant who has only rare occasion to concern himself with the Securities Act." True, this book is invaluable to such individuals, but it would seem that Mr. McCormick has been somewhat too modest. The book might well be studied by and retained in the library of those whose practice regularly involves work under the Act. The expenditure of the few hours which are required to read the book carefully, should prove to be a valuable investment of time to the practicing lawyer who rarely, if ever, gets into the field of public financing, and to the law student who is seeking a rounded background in this branch of corporate practice. Also, it is hoped that the personnel of the Commission will have examined the book and absorbed Mr. McCormick's approval of the administration of the Act.

Mr. McCormick has done a prodigious amount of work in assembling the information contained in the book. Only one who has worked understandingly and continually with the administration of the Act could have produced this kind of book. Whatever the efforts were that have gone into it, they are well worth while. It can only be hoped that a similar searching and informative treatise be compiled with respect to the Trust Indenture Act of 1939, the Securities and Exchange Act, and the Public Utility Holding Company Act of 1935.

ALBERT K. ORSCHEL*

Legacy of Sacco and Vanzetti, The. By G. Louis Joughin and Edmund M. Morgan. New York: Harcourt, Brace & Co., 1948. Pp. xvii, 598. $6.00.

Twenty-two years ago, after a trial and appeals spread over six years, two Italian-born, philosophic anarchists were executed by the Commonwealth of Massachusetts for murder committed during a payroll robbery. Massachusetts had not been a state singularly free of robbery, murder, or miscarriage of justice. Yet the question of the guilt or innocence of a skilled shoe-maker and a poor fish peddler divided America, and the world, brought forth recrimination and hysteria, and passed judgment not only on the accused but also on the true state of American democracy. For Nicola Sacco and Bartolomeo Vanzetti were executed as part of the struggle which determined whether

* Member of the Illinois Bar.

America should continue along the anti-monopoly paths of the Granger, Populist, and Progressive movements, or whether the corporate powers these movements had grown to fight should win new triumphs in the "bull market" and "dollar diplomacy."

Woodrow Wilson and the Democratic party had been elected to office in 1912, pledged to a program of social reform. Wilson's electoral victory was the culmination of forty years of protest by farmers, workers, and small businessmen against the accelerating growth of monopoly and the economic, social, and political dislocations which accompanied it. The accomplishments of the first two years of the new administration were modest, but in line with professed progressive ideology—tariff reform, a Federal Reserve System, and a new anti-trust law. But depression and war orders interrupted any other plans the Democratic administration might have had to restore America to the days of competition and comparative equality of opportunity. And when the United States entered World War I, Wilson found it necessary to turn over the conduct of the war to the representatives of the monopolies he had been elected to fight. The war needs of America and her allies did not permit strict conformity with the anti-trust laws in the allocation of war orders, even if the government had desired so to conform, and the trusts emerged from the short but profitable war with their strategic position in both the economy and government enormously strengthened.

The American people had been assured during the war by leaders of government and industry that the post-war era would be one of renewed social legislation, high wages and farm prices, and opportunity for little business. Instead, big business and its representatives and sympathizers in local, state, and national government moved to kill the remnants of the progressive movement once and for all. With government officials, press, and pulpit shouting warnings of a threatened red revolution, strikes were broken, unions destroyed, labor leaders and radicals arrested, foreign-born persecuted, teachers fired, reform legislation buried, and social criticism silenced. American experience in the hysterical 1920's and starving 1930's indicates that the campaign met with more than moderate success.

Sacco and Vanzetti were arrested during the height of the post–World War I red scare; were prosecuted by a vindictive attorney whose courtroom procedure made no pretense of seeking justice; were tried before a judge whose impartiality is open to serious question; were judged by a jury which could not help but partake of the red hysteria of the time and which was constantly reminded of the alleged relationship between the defendants' radicalism and physical violence; were heard in review by a superior court which carefully refused to consider the evidence or the case as a whole; and were refused executive clemency by a governor and review board prejudiced because of the defendants' politics and the threat to the "dignity" of the state's legal institutions.

The Legacy of Sacco and Vanzetti seeks to go beyond a mere determination of the guilt or innocence of the principals, and attempts to put the case in its total social perspective by combining the talents of Edmund Morgan of Harvard Law School and G. Louis Joughin of The New School for Social Research. Unfortunately, the resultant book merely juxtaposes Morgan's brilliant summation and evaluation of the evidence in the case with Joughin's sometimes interesting literary criticism, inadequate social analysis, and implicit appraisal of technics of social pressure.

In form, the first third of the study is devoted to Morgan's critique of the evidence, and the last two-thirds to Joughin's social and literary analysis. While Morgan's

handling of the evidence is masterful, it comes as something of a shock to the layman to find that one can discuss the Sacco-Vanzetti trial for ninety-five pages before getting around to the matter of the defendants' radicalism. And even then there is no effort made to discover why that radicalism could be used with such deadly effect by the prosecution. Apparently the question of the all-important environment of the trial was to be left to Joughin when he picked up the narrative on page 201.

Joughin, however, promptly informs the reader that "[t]he cause of this unhealthy hatred [of radicals] . . . lie[s] outside of this inquiry." He apparently believes that a social scientist can separate cause and effect, and then make valid investigations and evaluations of conditions which seemingly just happen to exist. Consequently, his section of the work is replete with question-begging generalizations such as "A sick society makes sick decisions," and when public opinion divided on the Sacco-Vanzetti case, "in one direction went the men who had to some degree grasped the fundamental quality of democracy, and in the other went those who had rejected that concept, ignorantly or willfully." Joughin follows "public opinion" in both directions, happily observing their outward behavior, but bringing his readers no closer to an understanding of social motivation than some mysterious grasp of the "fundamental quality of democracy."

As for those who did or did not grasp this democratic quality, we get another generalization about foreign-born and labor on the one hand (although labor is later described as largely indifferent), and the mysterious "general public" on the other. Joughin, either by direct refutation or by rejection as irrelevant, is quick to disabuse his readers of the possibility that American society was made up of contending interests struggling for position and power and that Sacco and Vanzetti were caught up in that struggle. Thus, while rejecting the theory that the two anarchists were convicted as labor leaders on the ground that they weren't active in union work, he quietly ignores any possible relationship between the post-war anti-union drive and the hysteria against foreign-born radicals. And while rejecting the attempts to organize mass pressure as insignificant and ineffective technics, and criticizing such attempts for antagonizing the powers who had the authority to grant clemency, Joughin gives unqualified praise to those social and intellectual leaders who sought to limit the campaign to free the defendants to a reasoned presentation of the evidence to influential members of the community.

All this adds up, despite Joughin's insistence that causation lies outside the scope of his study, to a theory of causation which permeates his entire work. The Sacco and Vanzetti case, in his analysis, becomes a struggle between democratic and anti-democratic "forces," and the history of Sacco and Vanzetti becomes the story of the attempt of the democratic forces to convince influential community leaders, who for some unknown reason were anti-democratic, of the rationality of the democratic position. Since, in Joughin's opinion, the democratic forces made a forceful presentation of the evidence, one can only wonder why the anti-democratic community leaders insisted upon executing the anarchists. Perhaps the question of democracy in our society raises problems in addition to that of well-mannered presentation of rational argument.

If, as Joughin holds, the legacy of Sacco and Vanzetti to society "lies in the emphasis which their fate gave to the continuing warfare between the forces of democratic and undemocratic action," then those whose interests lie on the democratic side had best seek to discover the underlying causes of that struggle. Neither the red scare which

followed World War I, nor the accelerating tempo of the campaign against civil rights now taking place are mere whims of history or the products of momentary irrationality leading to a strengthening of the anti-democratic camp. There have always been those in America who find civil rights an impediment to power and profits. The legacy of Sacco and Vanzetti shows that they cannot be defeated merely through expressions of confidence in the rationality of either our court system or our legal quarterlies.

IRA A. KIPNIS*

The Province and Function of Law. By Julius Stone. Sydney: Maitland Publications Pty. Lit., 1946. Pp. lxiv, 918. $15.00. U.S. and Canadian agents: The Carswell Co., Toronto.

A book entitled "The Province of Jurisprudence Determined" was published in 1832 by a certain John Austin, Professor of Jurisprudence at the newly founded University College of London. It was destined, after long initial neglect, to become one of the world's legal classics. Now, one hundred and fourteen years later, another English scholar, whom Australia has been fortunate to attract, has undertaken newly to determine "the province and function of law." The very title of the work indicates its ambitious scope, which is also indicated by the comprehensiveness of its contents as well as by the very size of this volume of roughly one thousand pages and its "bibliography of works cited" of forty-seven pages. Doctor Stone's work constitutes, indeed, a veritable encyclopedia of jurisprudential thought, especially of the last one hundred and fifty years, systematically arranged and critically illuminated. On the "schools" of jurisprudence from the Natural Law lawyers of the 17th century and their precursors to the contemporary—or should we already say, yesterday's—realists, the reader will find accurate information, concise and precise presentation of the principal tenets, acute critique, and respectful appreciation. Particularly welcome in this respect is the author's comprehensive presentation of the thought of Roscoe Pound, with whom Dr. Stone was closely associated for several years at Harvard. Previously, Pound's ideas had been distributed over a profuse number of monographic books and articles. They are now presented by Dr. Stone as a coherent and impressive whole. This entire book, indeed, appears as the performance of a task which Roscoe Pound had long been expected to carry out by himself, viz., that of tying together not only in his own amazing mind but in a book accessible to the public the vast mass of learning acquired in his long life as a student of law, jurisprudence, and human affairs, and systematically stating his own opinions on the principal problems of law and social life. Dr. Stone has had access not only to Roscoe Pound's living word but also to at least some of his private notes. Thus, in a sense, this present volume constitutes a summa of Roscoe Pound's work. Yet, Dr. Stone's *magnum opus* transcends the limits of a representation of the thought of his former teacher. The book is his and it culminates in the expression of his own well-considered and well-balanced thoughts about the feasibility of legally guaranteeing a minimum standard of living to every member of society without destroying intellectual and moral freedom.

As can be seen from its very table of contents and even more so from the footnotes, the book covers a vast field and is based upon a truly amazing store of learning. By one reviewer it has properly been said to constitute "ten volumes rolled into one."[1]

* Instructor, the College of the University of Chicago.

[1] Wright, Stone on Jurisprudence, 7 U. of Toronto L.J. 227, 237 (1947).

This very characterization reveals both the work's strengths and its weaknesses. While enjoying the rich fare offered by Dr. Stone, one cannot help missing a final coherence and consistency. This fault does not lie so much, however, in the execution of Dr. Stone's undertaking as in the very nature of the undertaking itself.

In its subtitle, Dr. Stone's work is called a Study in Jurisprudence, and in his general introduction Dr. Stone states that his topic is constituted by jurisprudence, which he then divides into the three main subdivisions indicated by the titles of the three parts of his book. The work thus belongs to that line of literature which was started by Austin and which continued by such authors as Holland, Pollock, and Salmond leads to such eminent recent works as those by Friedmann,[2] Paton,[3] and Dr. Stone. The fact that this science of jurisprudence hardly exists, as such, in any non-English speaking country, might give one pause to think. Of course, every one of the problems discussed in the English books on jurisprudence has also been discussed abroad. As a matter of fact, the major contributions to the discussion of these problems have been made by non-English thinkers. But rarely have non-English scholars tried to tie together all these various problems in one peculiar science called jurisprudence.[4] Law, as one of the most prominent phenomena of social life, has attracted the attention of specialists in many fields, such as historians, moral philosophers, economists, political scientists, psychologists, anthropologists, and sociologists. Every one of these specialists will look upon law from his own point of view, will try to correlate it with the problems and phenomena of his respective field, and will carry on that correlation with his own special methods. Needless to say, these problems and methods are different from those of the specialists of the law, both the legal practitioners and the legal scholars as they are or should be found in law schools. Needless to say, also, it is useful and stimulating to see what the representatives of other fields of learning have to say about the law. Jurisprudence, as it has developed in English speaking countries, constitutes the effort of lawyers to look upon their own field from the point of view of the other sciences, combined with a peculiar effort of legal scholars to refine their own methods in those ways which do not readily occur to the legal practitioners. The combination of these various excursions of lawyers into other fields and this peculiar extension of legal science is jurisprudence. Obviously, it is held together more by the personality of its adepts and the unity of the subject-matter of observation than by any unity of method.[5] It is obvious also that the jurist, who has had his basic training in the legal science of lawyers, cannot readily master the methods and insights of all the other social sciences. It follows as an inevitable result that the work of even the most universally ranging jurist cannot be entirely satisfactory. The futility of controversies between

[2] Legal Theory (1944).

[3] A Textbook of Jurisprudence (1946).

[4] In German, "jurisprudenz" means the knowledge and science of law, including quite particularly that "lower level of science" of law which is cultivated for the sake of its practical application by lawyers; it is the stuff making up the regular curriculum of a law school. In French, "jurisprudence," and correspondingly, Italian "giurisprudenza" and Spanish "jurisprudencia," means case law as contrasted to statute law. The terms most nearly corresponding to English "jurisprudence" are German "Allgemeine Rechtslehre" and French "Theorie Generale du Droit."

[5] It thus resembles a disquisition on, let us say, the horse, as seen from the point of view of the zoologist, the breeder, the farmer, the race-course man, the economist, the military man, the historian, the artist, the sociologist, and perhaps even the philosopher.

various "schools" of jurisprudence also becomes apparent. Efforts to write the history of a legal system or a legal institution are not antagonistic to efforts to determine the essence of justice, or to investigate the formal structure of legal propositions, or to determine the function played by the law in society in general. Happily, Dr. Stone has kept aloof from such sterile controversies. In his comprehensive system a niche has been found for every one of these endeavors. This achievement constitutes one of the great merits of his work. It has not been possible for the author, however, to master completely the methods of every one of the various sciences to which he resorts for the elucidation of the law. Indeed, who would ever aspire to such mastery? To a high degree Dr. Stone has shown himself to be at home in the social sciences in the narrower sense of the term, especially in political science and sociology; the third part of his book is thus the most satisfactory one. What satisfies least, however, is the first part, entitled "Law and Logic."

The author's use of the word "logic" is indeterminate, and clarity suffers further from his combination of two different sets of problems, viz., that of so-called analytical jurisprudence and that of the role of concepts in practical legal reasoning.

Today the most urgent problem which "jurisprudence" is expected to answer is that of determining the proper attitude of the judge toward the law. To what extent is he bound by the law, to what extent is he free from it? By long and often sad experience mankind has learned that no civilized community can endure when judicial decision is determined by individual whim and arbitrariness. Judges are supposed to be guided by the law. On the other hand, the legal order cannot provide ready-made rules for every conceivable controversy; of necessity, the law must have gaps. Furthermore, life changes and the law is not always adapted to the changes with sufficient speed. Hence, judges cannot be totally bound to the law. They must have a certain measure of freedom. But how much? The answer will have to change from place to place and from time to time. What answer shall be given here and now? Having passed through a period of remarkable stability, we are now finding ourselves in a period of rapid transition, in which judges must have a freedom greater than that which was conceded to them in the nineteenth century. Shall we therefore free them entirely from the binding force of the law? This has, indeed, been the proposal of some of the realists, only they expressed this counsel under the disguise of a postulate that judges be freed from the fetters of logic. If taken literally, that demand would mean that judges be freed from the fetters of consistent thought. However, that is hardly what is meant. But yet, the fight has been waged against the alleged fetters of the syllogism. The rules of law are expressed in general propositions. The controversies to be decided appear as concrete fact situations. The decision is found by syllogistically subsuming the minor premise of the concrete facts under the major premise of the rule. Shall this process be given up? Shall judges decide individual cases without even trying to formulate a general rule, perhaps a new one, of which the concrete case appears as an application? If so, the rule of law and the principle of equality are effectively terminated. Or shall we only say that, where the law is silent, the judge may formulate a new rule, and where it is obsolete, may modify the old, always insisting, however, that he express his major premise as a rule capable of general application? If we require this, how far shall the freedom of modifying or newly creating general rules go?

These questions are burning at this time and for guidance the lawyers are turning to the jurists. In Dr. Stone's book the problem is touched upon in numerous places,

but nowhere are the questions formulated as they have just been stated. Indeed, if the problem is seen as one concerning the relation between law and logic it can neither be formulated nor answered with clarity, since there can be no question as to that relation. As long as lawyers do not wish to incur internal inconsistencies of thought, they have to abide by logic. In speaking of internal consistency I do not mean that all the innumerable rules of law must necessarily be consistent with each other in the sense that they would all be expressive of one and the same policy, or that they would constitute conclusions derived in the process of logical implication from one single over-all principle. Such political consistency has been attained only in the dream systems of natural law writers or, perhaps, approximated in totalitarian dictatorships. It is unattainable in the complex democracies of the present. In places, Dr. Stone might be understood as suggesting that the unattainability of such political consistency ought to be regarded as an argument against the use of logic in the thinking of lawyers. But in justice to him it should be stated that he does not, or, at least, does not seem to, join with the radical realists' abjuration of logic. He is too cautious an Englishman to take such a radical position. But, on the other hand, he does not make it quite clear what in particular he is aiming at with his catalogue of faulty uses of logic in actual Anglo-American legal thinking. The sections making up this catalogue are among the most interesting parts of the book. They would seem to constitute an impressive invitation to the improvement of lawyers' thought, especially through the better formulation of the rules from which decisions are to be derived. Similar examples were at one time collected for German law by Heck and his colleagues and followers; they were used, however, by this so-called school of jurisprudence of interests for definite proposals as to the reformulation of the rules of law and the concepts used therein so as to replace ambiguous, meaningless, or empty concepts or concepts of a merely classificatory nature by concepts adequately describing the real interests at stake.[6] Unfortunately, when Dr. Stone wrote his book, the works of Heck and his school had not yet been translated into English. They might well have been used for demonstrating that the jurisprudence of concepts is an evil only when wrong concepts are used. But thinking without concepts is as unthinkable as talking without words; and equally unthinkable is rational thinking without logic.

In that part of Dr. Stone's book which deals with the relation between law and logic the discussion of the problems relating to the judicial process is combined with that of the so-called analytical jurisprudence. Apparently, the connection is seen in the fact that the analysis by the analytical jurists of the formal structure of the legal order, the rules of law, and the concepts used therein is regarded as a prototype of logical thinking. To some extent the connection may appear plausible as far as the Austinians are concerned, but it does not seem to do justice to Kelsen, although his system of thought itself is restated with remarkable clarity and objectivity. Dr. Stone emphasizes the great merit which Kelsen has achieved through his exposition of the specious nature of that way of reasoning which tries to solve problems of policy by the allegation of some spurious logical necessity. It may be doubted, on the other hand, whether the reader obtains a full impression of the fact that Kelsen has addressed himself to problems of a thoroughly practical character, especially the problem of furnishing the judge with clear tests for determining whether a proposition purporting to be a

[6] Twentieth Century Legal Philosophy Series. Vol. II. The Jurisprudence of Interests (1948).

rule of law really is a rule of law, or the problem of clarifying the scope of the law-making power of judges, administrative agencies, or private parties.

The second part of Doctor Stone's book, entitled "Law and Justice," is devoted to the critical presentation of the schools of Natural Law, Metaphysical Individualism (Kant), Individualist Utilitarianism (Bentham), Social Utilitarianism (Jhering),[7] Social Idealism (Stammler), Neo-Hegelian Civilization Theory of Justice (Kohler), Social Solidarism (Duguit), and Pragmatism (Pound). The presentation is lucid and the criticisms are well taken. None of the various schools is credited with having found *the* answer to the quest for justice, but they all are recognized as having met peculiar needs of their respective times, having brought into focus the available alternatives, and, through their very manifoldedness, having helped to create an attitude of diffidence as to individual choices "which will permit manifest errors to be more quickly detected and remedied as experience discloses them." The author's own attitude is thus revealed as one of sceptical though optimistic pragmatism which finds articulate expression in the final chapter of his book.

The schools of thought discussed by Doctor Stone are those which one would generally expect to find discussed in a book on "legal philosophy." They are all centered not so much around any peculiar problem of the law as around the general problem of justice. It is generally postulated of the law that it be just. But what is the just law? It is that law which is apt to be helpful in bringing about the just social order, "the good society." Discussions on the law and justice have usually been concerned not so much with the technical problem of law in detail as with the ethical problem of how the social order should be constituted so as to deserve to be called just. This problem of the good society has occupied the world's philosophers for many centuries. It has not been a peculiar domain of the lawyers, but what is being traditionally called legal philosophy is the thought of philosophers or amateur philosophers who were either simultaneously, or primarily, lawyers, or who, like Kant, gave to some part of their philosophical systems the title "philosophy of law." There are traditionally excluded, however, from treatises on "legal" philosophy those "mere" philosophers who, not being lawyers, have concerned themselves with the problem of the good society as such. Also generally excluded from a discussion which by its nature transcends national boundaries are those "legal philosophers" whose works have not yet been translated into the language of the particular author. Thus one does not yet find in Doctor Stone's book the ideas of, for instance, Dabin of Belgium, Lask, M. E. Mayer, and Radbruch of Germany, or Recaséns Siches or Carlos Cossio of Latin-America, not to speak of such representatives of unorthodox thought as Pashukanis or Vizhinsky of the U.S.S.R., Carl Schmitt of National-Socialist Germany, or Rocco of Fascist Italy. Their inclusion might, perhaps, have revealed that the "liberal" thinkers who are represented in the book have in common a greater measure of agreement than becomes apparent without a contrasting foil.

The third part, which is entitled "Law and Society," and which covers more than half of the book, is concerned with that field which the author alternatingly calls "Sociology of Law" and "Sociological Jurisprudence." It is questionable whether these two terms should not better have been differentiated from one another. Sociology of law is the heading more generally used for the theoretical inquiry into the function of law in

[7] This is the correct spelling of the name and *not* "Ihering," as it is consistently misspelled in the book.

society in general; sociological jurisprudence, on the other hand, is the practical method of utilizing sociological data in the judicial process. In that sense, sociological jurisprudence would belong together with those problems of the judicial process which the author has treated in the part of his work on logic. Indeed, the third part is concerned primarily with "Sociology of Law," i.e., with the function of the law as a means of social control. Such a discussion would seem to require at the outset a clear distinction of the law from other means of social control such as etiquette, ethics, or religion. Doctor Stone consciously refrains, however, from attempting any such differentiating definition of the term "law." He states that it "seems preferable at this date to cease hankering after some one simple criterion of 'lawness'."[8] If, as it must be conceded, it would not have been easy to find any one simple criterion, it might still have been possible to state at least the tests by which law, the subject-matter of his work, is understood by the author himself. Less self-restraint in this respect might well have changed the contents of the main part of his book which now, although not consistently, appears more as a general theory of society written by a legal scholar than as a determination of the relations between legal and other techniques of social control. What we find in this part, as it stands, are presentations of the thought of the "historical" schools of law of both Germany (Savigny) and England (Maine) which, as Doctor Stone's presentations of other schools of thought, are lucid and well-balanced. We then find the series of chapters already mentioned in which, elaborating upon bases laid by Roscoe Pound, Doctor Stone analyzes those interests, both individual and social, which present Anglo-American law is meant to protect. These chapters belong more to sociological jurisprudence as a guide for English and American judges than to sociology of law as a general theoretical science. Yet, since a comprehensive discussion of this kind can rarely be found upon the practitioners' level, it may be justified to include it in a book dwelling on the higher level of jurisprudence. The elaborate catalogue of interests is, no doubt, stimulating for thought and valuable in judicial practice but we must ask whether it is enough for the judge to know what interests are being protected by the legal order, and whether he does not also have to know how these various interests are evaluated by the legal order when they come, as they continuously do, in conflict with one another. The essential task of the law is that of deciding between conflicting interests, and every single rule of law constitutes a decision, frequently having compromise character, between conflicting type interests. When confronted with a "new" case the judge has to utilize the official value judgments expressed in the existing rules of law, as well as those inofficial ones which live inarticulated in society as contents of its ethical convictions. The "jurisprudence of interests," to which reference has already been made,[9] gives, I believe, more helpful assistance in this judicial task than a mere listing of those interests which have, in one way or another, found protection in our law.

In spite of the author's reluctance to bind himself to one single definition of law, and his consequential tendency to discuss the general problem of social control, he has found himself compelled in the last subdivision of his third part, by and large to use the word law in the sense of state-enforced rules of behavior. Otherwise, there would have been impossible any discussion of the various theories denying the law's existence or justification, or of the significance for law of socio-ethical pressures ("social use and wont") and of power. Yet, the reluctance to use this definition more consistently has

[8] P. 717.

[9] P. 757 supra.

debarred the author from an inquiry into certain problems which one might expect to find in a treatise on sociology of law. One of these is the effectiveness of governmental regulation, in general and in comparison with other techniques of social control. The problem seems to be touched upon in several places, but where it seems to be treated, closer analysis reveals that we are faced with another problem of a different character. In his extensive writings, especially his *Sociology of Law*, Eugen Ehrlich has at length dwelt upon the phenomenon that in numerous social relations, e.g., in marriage, a sale, a contractual relation, a testamentary disposition, or a business partnership, numerous details are regulated by the parties themselves in some manner different from that set out in the rules of law as they appear in a code, a statute, or judicial case law. From this observation Ehrlich concluded that there not only existed, but was bound to exist, a discrepancy between the law of the books and the law in action. This conclusion was not justified, however, since in almost all of the cases observed by Ehrlich the rules of the books are rules which by their very own terms are not to be applied unless the parties to the transaction have failed to set out their own terms. The failure to recognize this fact was astonishing in a man like Ehrlich, who, as a professor of Roman law and Civil law in Australia, was, of course, thoroughly acquainted with the distinction between strict law, i.e., law purporting to apply independent of any intention of private parties, and dispositive law, i.e., law applicable only in the case of the party or parties concerned having failed to set out their own terms.[10] Dr. Stone cannot be blamed when he, in whose legal system the distinction, although existing, has never been clearly formulated, took over the error of Ehrlich. The problem of the effectiveness of the law can properly be raised only with respect to the strict law and it is found in its most puzzling shape in those situations in which not only a considerable proportion, perhaps even the majority, of the public fails to obey a law but where it is also winked at by the very law enforcement agencies. This problem, on which some acute observations have been made by Thurman Arnold[11] as well as by law review commentators on the law of divorce, is not discussed by Doctor Stone. Then, there is the set of problems which arise when in a society the law has become the domain of a group of specialists who, following their own traditions and techniques, in the course of time bring about a discrepancy between the rules of law and the practices and ethical convictions of the people at large. Some aspects of this problem are dealt with in connection with the famous lag which so many social scientists claim as inevitably existing between the law and the mores. Whether this lag is really inherent in the law is questionable. In colonial areas and in enlightened despoties the law has often run ahead of the mores, as it has occasionally done in democracies when some progressive minority has succeeded, through skillful manoeuvering or otherwise, to obtain legislative adoption of a proposal for which the majority mores have not been ready. The lag is not the only expression, however, of the more extensive phenomenon of discrepancy between a law manipulated by legal specialists and the mores. It arises, for instance, whenever a foreign legal system is "received" wholesale, as Roman law was received in fifteenth and sixteenth century Germany, or as Western codes have been adopted in our times in Japan, China, Turkey, and other Eastern countries. The phenomenon occurs also in our own society

[10] As a matter of fact, one of Ehrlich's own early writings was concerned with the problem. It is entitled "Das Zwingende und nichtlungen zum Privatrecht und Civieprozess" (1899).

[11] The Symbols of Government, esp. 148 et seq. (1935), and Folklore of Capitalism, *passim* (1937).

when the lawyers, carried along by their concern about technicalities or other motives, render the law so intricate that it can no longer be understood by the laymen whose conduct it is supposed to regulate. These problems, which were clearly recognized and formulated as early as in 1843 by Georg von Beseler,[11] are serious and ought to be discussed in the sociology of law.

Finally, there is one problem which may well be called to be of central importance —that of the peace and order function of the law. What was the role played by the law in the establishment of peace and order in primitive communities and in the elimination of the feud and internal warfare in those nations which were to mature into the states of our present world? Which role can the law be expected to play in the "outlawry" of war and in the establishing of a more peaceful world order? This problem of international law, which is so vital in our own days, is hardly touched upon in this book on the province and function of law.

Much space has been given in this long review to criticism. This very fact should indicate that we have been dealing with an important book. Doctor Stone has given us the most comprehensive modern treatise on jurisprudence. The width of his knowledge is admirable, his judgment of other men's theories is eminently fair, the new insights developed by him are numerous and helpful, his style is facile, and the reader will be delighted by the skillful expression of criticism in those respectful phrases in which English lawyers are wont to argue against each other. That the work does not completely satisfy is due primarily to its very task itself. This task has been simultaneously too narrow and too broad. It has been too narrow in that the author's own observations are almost exclusively derived from the common law of England and its derivatives. If "jurisprudence" wishes to be a general theory of law, it has to take its materials from the laws of all times and climes. The task has been too broad, however, in that it has not been limited to problems peculiar to the technique of social control through governmental compulsion, but has also tried to embrace the immense field of social control in general as well as the eternal problem of the good society. Jurisprudence is too vast a province to be completely explored by one man. It will have to be divided up into several provinces, every one of which at this time requires a vast amount of exploratory work. As the results become available, lawyers will have to utilize them for the improvement of their art and the deepening of their understanding. Doctor Stone's far flung exploration can constitute a stock-taking, revealing what we already know and in what respects further work needs to be done by the specialists of the various social sciences.

MAX RHEINSTEIN*

[11] Volksrecht und Juristenrecht.

* Max Pam Professor of Comparative Law, University of Chicago Law School.

BOOKS RECEIVED

American Political Mind, The. By Francis G. Wilsch. New York: McGraw-Hill, 1949. Pp. ix, 506. $5.50.

American Suffrage Medley, The. By Dudley O. McGovney. Chicago: The University of Chicago Press, 1949. Pp. vii, 201. $4.50.

Annual Summary of Laws and Regulations Relating to the Control of Narcotic Drugs—1947. Lake Success: United Nations Publications. Pp. xii, 40.

Cases and Materials on Civil Procedure. By Atkinson and Chadbourn. Brooklyn: The Foundation Press, 1948. Pp. 910. $8.50.

Cases on Labor Relations. By Harry Shulman and Neil W. Chamberlain. Brooklyn: The Foundation Press, 1949. Pp. x, 1266. $8.00.

Classification—Class K—Law. Prepared by Elizabeth V. Benyon. Washington: The Library of Congress, 1948. Pp. 172.

Collective Bargaining—Report Number 3. By Herman Lazarus and Joseph P. Goldberg. Washington: The Public Affairs Institute, 1949. Pp. 72.

Delivered Pricing and the Future of American Business. Washington: Chamber of Congress of the United States, 1948. Pp. 232. $1.50.

Development of the Law of Belligerent Occupation, The. By Doris Appel Garber. New York: Columbia University Press, 1949. Pp. 343. $4.00.

Freedom and the Administrative State. By Joseph Rosenfarb. New York: Harper and Bros., 1948. Pp. xiii, 274. $4.00.

History of English Criminal Law and Its Administration from 1750, A. By Leon Radzinowicz. New York: The Macmillan Co., 1949. Pp. xxiv, 853. $15.00.

Introduction to Accounting for Students of Law. By Wilber G. Katz. Chicago: The University of Chicago Press, 1948. Pp. 96. $2.00.

Introduction to Income Taxation. By James M. Henderson. Rochester: The Lawyers Co-operative Publishing Co., Pp. x, 535. $7.50.

Joint Safety Program of the Forstmann Woolen Company and Local 656 Textile Workers Union of America, CIO, The. By Richard H. Wood and John J. Pearce, Jr. New Brunswick: Rutgers University, 1948. Pp. 47. $.40.

Kalingas, The. By R. F. Barton. Chicago: The University of Chicago Press, 1949. Pp. viii, 275. $4.00.

Labor and the Law. By Charles O. Gregory. New York: W. W. Norton & Co., 1949. Pp. 523. $5.00.

Law and the Modern Mind. By Jerome Frank. New York: Coward-McCann, 1949. Pp. xxxi, 368. $5.00.

Law and You, The. By Max Radin. New York: Mentor Books, 1948. Pp. 190. $.35.

Law Reports of Trials of War Criminals, Vols. V–XII. London: His Majesty's Stationery Office, 1949. 5s. od. net (each vol.).

Legal Philosophy from Plato to Hegel. By Huntington Cairns. Baltimore: The Johns Hopkins Press, 1949. Pp. xv, 583. $7.50.

Local Government Law. Text, Cases & Other Materials. By Jefferson B. Fordham. Brooklyn: The Foundation Press. 1949. Pp. xxx, 1060. $8.00.

Mr. Justice Black: The Man and His Opinions. By John P. Frank. New York: Alfred A. Knopf, 1948. Pp. xix, 357. $4.00.

New York University Seventh Annual Institute on Federal Taxation. Albany: Matthew Bender & Co., 1949. Pp. xvi, 1487. $20.00.

People Know Best, The. By Morris Ernst and David Loth. Washington: Public Affairs Press, 1949. Pp. 169. $2.50.

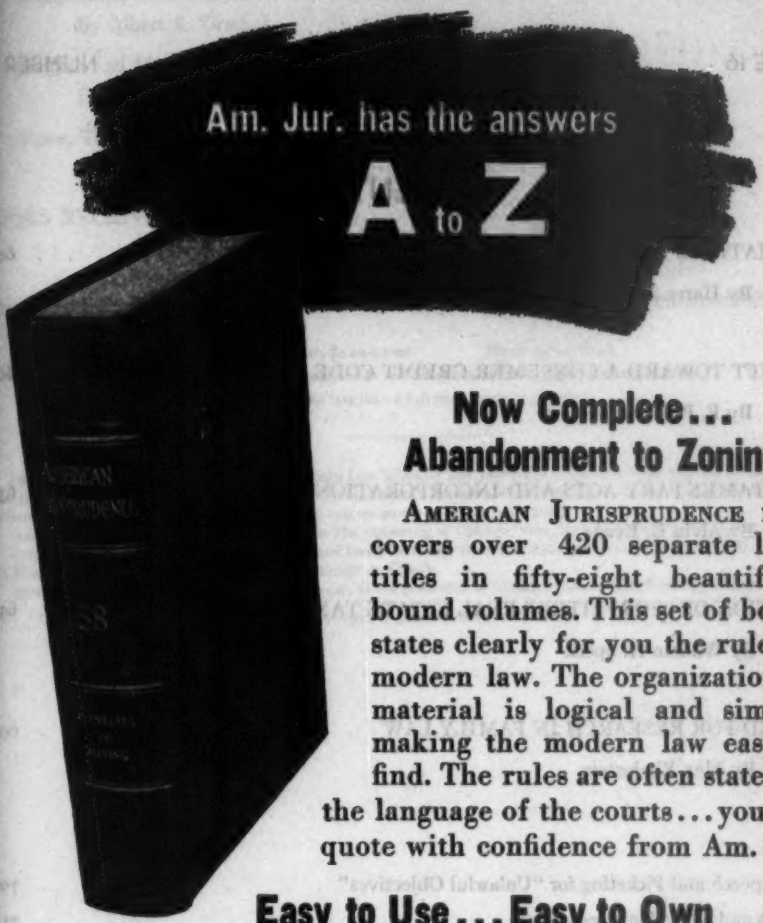
State Law Index, An Index to the Legislation of the States of the United States Enacted During the Biennium 1945–46. Washington: United States Government Printing Office, 1948. Pp. vii, 729. $2.50.

Successful Trial Tactics. By A. S. Cutler. New York: Prentice-Hall, 1949. Pp. ix, 319. $5.35.

Rational Basis of Contracts and Related Problems in Legal Analysis, The. By Merton Ferson. Brooklyn: The Foundation Press, Inc., 1949. Pp. ix, 330. $4.00.

Renegotiation of War Profits, The. By Richard C. Osborn. Urbana: The University of Illinois, 1948. Pp. 112.

What Every Corporation Director Should Know. By Percival E. Jackson. New York: The William-Frederick Press, 1949. Pp. xv, 198. $3.50.



Now Complete... Abandonment to Zoning

AMERICAN JURISPRUDENCE now covers over 420 separate legal titles in fifty-eight beautifully bound volumes. This set of books states clearly for you the rules of modern law. The organization of material is logical and simple, making the modern law easy to find. The rules are often stated in the language of the courts... you can quote with confidence from Am. Jur.

Easy to Use... Easy to Own

Designed for the busy lawyer, Am. Jur. has the clearest possible analysis of legal subjects. Its ease of use saves you time and the convenient payment plan makes ownership a pleasant possibility.

Associate Publishers

THE LAWYERS CO-OPERATIVE PUBLISHING CO., ROCHESTER 3, N. Y.
BANCROFT-WHITNEY COMPANY - - SAN FRANCISCO 1, CALIFORNIA

THE UNIVERSITY OF CHICAGO LAW REVIEW

VOLUME 16 SUMMER 1949 NUMBER 4

CONTENTS

APPRECIATIONS 605

By Harry A. Bigelow and Wilber G. Katz

THE DRIFT TOWARD A CONSUMER CREDIT CODE 609

By F. B. Hubachek

NONTESTAMENTARY ACTS AND INCORPORATION BY REFERENCE . . . 635

By Alvin E. Evans

COLLECTION OF "FORFEITED" REAL ESTATE TAXES IN ILLINOIS 655

By William H. Speck

THE NEED FOR RESEARCH IN FAMILY LAW 691

By Max Rheinstein

NOTES

Free Speech and Picketing for "Unlawful Objectives" 701

Church and *Spiegel* in Perspective 711

RECENT CASES

Income Tax Consequences of Cancellation of Indebtedness. *Com'r v. Jacobson*, 69 S. Ct. 358 (1949) 725

Rights of Beneficiaries under Facility of Payment Clauses. *Matejicska v. Metropolitan Life Ins. Co.*, 335 Ill. App. 81, 80 N.E. 2d 278 (1948) 734

Application of Strike Suit Statutes in Federal Courts. *Beneficial Industrial Loan Corporation v. Smith*, 170 F. 2d 44 (C.C.A. 3d, 1948) 738

Restraints on Alienation of Stock Certificates. *Tracey v. Franklin*, 61 A. 2d 780 (Del. Ch., 1948) 742

BOOK REVIEWS

McCormick, UNDERSTANDING THE SECURITIES ACT AND THE S.E.C. 748
By Albert K. Orschel

Joughin and Morgan, THE LEGACY OF SACCO AND VANZETTI 751
By Ira A. Kipnis

Stone, THE PROVINCE AND FUNCTION OF LAW 754
By Max Rheinstein

BOOKS RECEIVED 762

Subscription Price, $4.00 a year Single copies, $1.35
Foreign Subscriptions, $4.60; Canada and Newfoundland, $4.24 in American currency
Service for less than a full year, single-copy rate

Published quarterly by The University of Chicago Law School at The University of Chicago Press, 5750 Ellis Ave., Chicago 37, Illinois. Authorized agent: Cambridge University Press, London. Patrons are requested to make all remittances payable to THE UNIVERSITY OF CHICAGO LAW REVIEW in postal or express money orders or bank drafts.

Business correspondence should be addressed to The University of Chicago Press, 5750 Ellis Avenue, Chicago 37, Illinois.

Communications for the editors, manuscripts, and books for review should be addressed to the Editor-in-Chief, The University of Chicago Law Review, University of Chicago, Chicago 37, Illinois.

Entered as second-class matter December 24, 1947, at the post-office at Chicago, Illinois, under the Act of March 3, 1879.

Copyright 1949 by the University of Chicago

[PRINTED IN U.S.A.]

The Law Changes

Year after year new statutes are being enacted in State and Federal legislatures; old statutes are being amended, revised, repealed, re-enacted or superseded.

The vast number of changes now taking place necessitates a clearing house that gives immediately to the members of the Bench and the Bar, the legislative history of any code section or statute they desire to investigate.

In every edition of "Shepard's Citations" to the various State Reports and the United States Supreme Court Reports, there is a section familiarly known as "Citations to Statutes". This division of the Shepard publications gives the investigator just the information he needs to keep abreast of the rapidly changing State and Federal laws!

Shepard's Citations
Colorado Springs
Colorado

Copyright, 1949, by The Frank Shepard Company

Please mention the REVIEW when answering advertisements